Investors' Guide to Special Situations in the Stock Market by Maurece Schiller **(1966)** *Referenced and suggested by Joel Greenblatt (2006).*

Lesson: These opportunities will never go away.

STUBS

Stubs represent *residual* interests of companies in process of liquidation. These terminal securities exist because of specific and contingent values remaining to be processed. Reserved and un-liquidated properties are repositories of real assets while litigation usually holds clues to contingent interests. Stubs come into being as a result of a major distribution of assets by a company in liquidation. The withheld portion of total assets and claims to be cleared are assets underlying the residual Stub. A Stub then is unfinished business.

Among names for securities having characteristics of stubs are: Certificates of beneficial interest, Certificates of Participation, Certificates of Contingent Interest, and Receipts, Scrip, Stub equity and Liquidation Certificates.

Another definition….

A **stub** is the stock representing the remaining equity in a corporation left over after a major cash or security distribution from a buyout, a spin-out, a demerger or some other form of restructuring removes most of the company's operations from the parent corporation. A stub may retain the name of the original corporation, or in some cases may take another name as part of the restructuring.[1]

CAPITAL GAIN POTENTIALS

Bona fide values inherent in Stubs harboring capital gain potentials may be uncovered in the following Corporate Financial reports:

Stated net assets.

Tax litigation.

Litigation wherein company is claimant.

Reversionary provisions in an agreement between company and security issue.

Reserves established for specific contingencies that may or may not materialize.

Capital gain potentials in Stubs reflect discount from indicated value and to that extent they are undervalued. The rate of return on money invested should be viewed in relation to expected duration period for holding the Stubs. Stubs represent non-operating companies and as such it is unlikely that earned income will accrue. Therefore, the sole return on money invested will arise as capital gains. Where cost price is relatively low compared to expected potential gain, and then rate of return could be projected over a five year period. If such "timing" would offer a minimum 10% return, then the situation holds interest.

A usual practice in Stub liquidating procedures is distribution in small doses of the remaining assets. Therefore, a good approach when investing in Stubs is to calculate when final distributions are being made so that little or no money remains in the Stub. Thus, in the life of a stub while time is a factor, it is not a source of concern.

Stubs are money deals in that one invests X dollars and expects X dollars in return. While there is little expectancy of additional values developing, it has been observed over the years that Stub situations, particularly those involved in tax litigations can bring windfalls of substantial, unexpected additional payments.

IDENTIFYING NAMES

Residual interests in a company are not only known as Stubs but are also called **Certificates of Participation; Certificates of Beneficial Interest; Certificates of Contingent Interest; Liquidating Certificates; Reversionary Certificates.** These are *negotiable instruments* and are traded in securities markets. Physical stubs are original stock certificates over-stamped with the legend describing distributions *(in 1966)*.

Some liquidating programs do not use Stubs. In these circumstances, stock certificates are deposited with a bank or trustee who processes the remaining liquidating steps. Distributions are made directly to security holders' whole names appear as registered owners at time of first distribution. While this does not make for ready negotiability, nevertheless these residual interests may be traded, i.e. purchased and sold in the securities market by use of "contracts." Generally, contracts are recognized by trustees of liquidating companies as legal transfers. A point to keep in mind is that since Stubs represent the final stage of a company's existence, assets may be placed in care of a trustee. The liquidating company and bank processing liquidating distributions can advise on location of the trustee. It is helpful to have your name on the trustee residual interest list since this is the main source of information. The trustee will keep you informed on final action, litigation and distributions.

HOW TO ESTABLISH A STUB POSITION

Investors can acquire Stubs through two procedures. One, of course, is direct purchase in the market after they have been established. When residual assets are complex and a Stub is subject to price fluctuations, this approach is most practical. *Delhi Contract Units* is an example of fluctuation of stubs since issuance, having been priced at $4 and then around $3.

The other method offers possibility of creating a Stub position at low or no cost basis. This is a more frequently used procedure. The method is to purchase stock of a company in liquidation prior to the primary distribution. It is not unusual for a stock to be priced around or even lower than indicated initial distributions during the early part of the liquidating procedure or at time of announcement of proposed liquidation. Since the amount of the first distribution is known, it is a simple matter to calculate cost of Stub by deducting amount of indicated distribution from market price. Purchase of stock in expectation of a liquidating distribution posed no tax problem since the distribution generally is treated as "return of capital" and as such reduced the investor's cost basis.

ANALYSIS OF STUBS

Financial analytical procedure separates real assets from contingent potentials. Indicated net worth of a Stub is often stated by a company in its liquidating program. Asset value can also be gleaned from a company's balance sheet issued at time of the proposed liquidation plan, deducting initial distribution from indicated asset value. True residual assets show up clearly—and since a terminal situation has little or no expenses, these assets should remain constant. Principal assets of Stubs comprise cash, marketable securities and unsold properties. Ultimate values may be influenced either beneficially or adversely by disposition of reserves and litigation. Having calculated an indicated asset value, the amount of reserves and composition of litigation must be evaluated. This is generally found in Notice of Meeting dealing with liquidation or other corporate actions. The schedule of estimated payments should be checked since you want to know why funds are being held for distribution.

Values in Stubs arise from two sources, real assets and contingent claims. Real assets are usually clearly defined since, by definition, a Stub represents remaining assets after liabilities have been satisfied. However, litigation or claims are not fixed amounts and settlement usually is subject to compromise and adjustment. Since contingencies offer potential capital gains, it is advisable to estimate values of claims on a basis of win all—a midway compromise—or lose all. This spread of values offers a basis for estimating ultimate worth of the Stub.

ESTIMATING MAXIMUM AND MINIMUM VALUES

A helpful approach to Stubs is to evaluate maximum and minimum values. To do this we look at real and contingent values from many angles.

Step One relates residual net assets to cost of Stub. If the Stub was acquired by purchase of stock prior to first distribution, then cost is price to stock less amount of that distribution. For example, if stock cost $21 a share and distribution was $20 per share, the cost of Stub would be $1 s share. If stock cost $19 a share and distribution was $20 a share, then cost basis is minus $1, or no cost. Direct purchase of Stub, of course, immediately establishes your cost price.

In Step Two, we assume company is the defendant in contingency actions and we view these claims as having been lost. On this basis, reserves held for such claims have been consumed. Therefore, the only values accruing to the Stubs will be net value. This amount is the minimum expectation.

Step Three views the situation assuming that claims against reserves are not upheld. In that case, reserves accrue to Stubs. The reserves and net asset value are added to give maximum expectancy based on no erosion of reserves.

Step Four views the company as a claimant in litigation; In this case, claims may redound to Stub holders. However, if claims are lost, nothing is added to asset value. If claims are won, then value of claims and assets are joined to give maximum expectation. In the foregoing circumstances, minimum and maximum expectations have been conjectured under varied conditions whereby company wins or loses as a defendant and company wins or loses as a claimant.

HIDDEN VALUES

Where distribution to Stubs included securities of another company, it would be advisable to check the tax status of that company. This may have great value in bringing to light a tax loss carryover applicable to the shares. Such a situation arose a number of years ago when *American Power & Light* distributed shares of *Portland Gas & Coke.* A tax ruling permitted the cost of *Portland Gas & Coke* stock to be computed at $69.87 a share. Since the stock was priced under $20, shareholders were in a position to create a substantial loss position.

Stubs that reflect litigation as the main cause of their protracted existence include *British Columbia Power* and *Holyoke Shares*.

Types of Stubs

The individual characteristics of a Stub represent their motive for existence. The **Common Stub** comes about from residual assets in a liquidating company. *Ridgeway Corp.* is representative of a Sub having definite assets awaiting sale. Stubs such as *Delhi Taylor Oil* and *Producing Properties* exist because of precautionary measures against claims that may arise. **Certificates of Participation** represent interests in a reserve fund created to expedite liquidation. *AVC Co. Participating Certificates* is an example of this type. Reversionary Certificates reflect the turning action implied in the name. This type of Stub may be viewed as a return of property at expiration of a lease. However, a reversionary agreement may not be confined to a Stub, as seen in the *Western Union* situation. Here the company has an agreement with *Gold and Stock Telegraph Company*. To return substantial assets at termination of a long-term lease due on January 1, 1981. Funds to meet this reversionary claim are carried on *Western Union's* book as deferred non-interest bearing liability and are included on the balance sheet in long-term debt. The **Reversionary Certificates** of *Western Railroad of Alabama*, on the other hand, are entitled to one share of stock of the railroad when reversion becomes effective in 1980.

Other stubs represent interest in varied claims, such as *PACO, Inc.* where the Stub's interest is based on the amount of tax refund.

Certificates of Beneficial Interest arise where assets of a liquidating situation are placed in trust. This may be seen in *Canal Bank & Trust*. Where income would be subject to depletion charges and thus free from tax.

1959 Edition, How to Profit from Special Situations in the Stock Market by Maurece Schiller

Since stubs may originate in various investment areas it would be helpful to classify them for easy recognition. Classification is additionally useful since a stub's category can point to its profit possibilities. The accompanying tabulation classifies stubs as to place of origin, issuing company, and type of corporate action which created them.

Place of Origin	**Issuing Corporation**	**Type of Corporate Action**
Merger/Acquisition	Owens-Illinois Glass	Reserve for undesignated Claims
Reorganization	Consolidated Retail Stores, Inc.	Accrued-dividend claim
Recapitalization	Atlanta & West Point RR, Western RR of Alabama	Reversionary claim Reversionary claim
Tax	Standard Gas & Electric	Tax suit
Liquidation	Ridgeway Co.	Residual asset
Legal suit	International Paper Company	Contingent Reserve Claim

Dissolution	American Power & Light	Liquidation and tax ruling
Reorganization	New York N.H. and H. RR	Beneficial Interest.

Besides placing a stub in its proper corporate-action category, it can be subdivided into type of assets which support each claim. These are: fixed assets, participating assets, and fluctuating assets.

The fixed-asset stub is a discount situation against a cash claim. The *Consolidated Retail Stores* example discusses the stub in relation to a claim for a specified amount of money.

Because a stub is, in itself, a corporate action, comprehensive information about it is usually available from the issuing corporation.

Probably the best way to evaluate a stub is to know the reasons for its existence. This will show the potential worth and the probable duration period required for the stub's termination.

Since a stub generally is created to meet a specific condition, no typical stub exists. Therefore, each stub should be examined for a possible windfall, which often raises profits above the initial estimate.

Stubs Representing Undesignated Claims

Owens-Illinois Glass. **Escrow certificates** were issued in October 1956, and were priced around $1.25 in the unlisted market. Currently the certificates are priced around $1.88, reflecting the approaching termination date and the absence of significant claims against the reserve fund. The certificates represent a potential participation in 92,587 shares of *Owens'* preferred stock, which was placed in escrow to protect *Owens* against any contingencies arising from the merger with *National Container Corp.* Each escrow certificate has $2.25 in par value of *Owens* 4% preferred stock held for eventual distribution to its holder. Normal termination of the escrow is December 31, 1960. This stub has an unusual feature in that the preferred stock is convertible into 1.05 shares of *Owens-Corning Fiberglass Corp.* until 1963, at which time the conversion becomes one share.

This stub offered at its inception an estimated profit of $1 for each $1.25 invested. Since the duration would be four years, the indicated rate of return is 20%. The present price of $1.88 reflects this rate of return. A purchase at $1.25 would now show a profit of 62.5 cents, or a return of 25% for the two years during which the stubs would have been held. The quality of *Owens'* preferred stock gave the situation a minimum-risk rating, and the conversion feature, which could become valuable offered *romance*.

Stubs Representing Accrued-dividend Claim

Consolidated Retail Stores **scrip (stubs)** came into being in October, 1957, at a price around 50 cents in the over-the-counter market. They subsequently rose to $1. This showed a 100% profit in one year. The stubs were issued to the former 4.25% cumulative preferred stock, Series A, in settlement of accrued dividends. These certificates entitle holders to receive the accrued dividends in cash before any dividends are declared on the recapitalized preferred and common stock. The accrued and unpaid dividends amounted to $2.65 as of July 1957. As the certificates were priced around 50 cents, this was equivalent to purchasing a claim of $2.65 for 19% of its face value.

Payments on these certificates depend upon the successful operation of the reorganized enterprise. There are 44,490 shares of old preferred outstanding, against which $142,000 of dividend scrip was issued. The reorganization of this company is discussed below:

The Consolidated Retail Stores reorganization presents an ideal illustration of an opportunity for substantial profits most readily recognized by those investors whose sights have been oriented toward special situations. The company's difficulties had been aired in the newspapers a long time before the formal announcement of reorganization.

Official notification of the proposed plan of recapitalization and debt arrangement was presented in the notice of a special meeting to stockholders. The company had been operating since September, 1956, under Chapter XI of the Bankruptcy Act. The special meeting was called for Sept. 10, 1957. The plan was released to the public on Aug. 2, 1957. The market prices of the securities at that date were: preferred stock approximately 10.5; common stock approximately 2.875.

The gist of the plan was an offer by *Mr. A.M. Sonnabend*, who proposed to settle the debts of the defunct company in return for control of the corporation. Depending on various optional factors in the recapitalization, *Mr. Sonnabend's* stock interest in it would range from 45% to 56.8%. The details of the plan follow:

Creditors of the company with claims under $100 and those with priority claims would be paid off in cash totaling $141,397. Other unsecured claims would be settled by issuance of non-interest-bearing ten-year promissory notes for 85% of the claim, totaling $4,656,993. The 15% balance of each claim would be satisfied with two year, 5% convertible notes, of which $821,821 would be issued.

The plan proposed reclassification of each o0utstanding share of common stock into one half share of recapitalized commons and each preferred (4.25%) stock into one share of 5% preferred and four of the new common shares. The new preferred would be convertible into five new common shares.

The new preferreds would also receive warrants for accrued dividends amounting to $2.65 as of July 1, 1957. The estimated values of the new securities and the package to be received as related to the preferred and common stock follows:

For each share of 4.25% preferred	Estimated Value
The holder would receive:	
One share new preferred ($20 par) convertible into five common shares	$10
Four shares new common stock	$8
One Warrant for accrued dividends, nominal value*	$18
Estimated value of securities to be received	
For each old common share the holder would receive:	$2
One-half of new common	

The foregoing projections were based on estimates made around mid-August. As the old preferred was priced around the $13 to $14 level, a substantial profit potential existed through purchase of the shares. Contrawise, as the old common was priced around $23 and the holder would receive only half a share of the new stock, the common as too high. Consequently profit possibilities via a hedging procedure were contingent upon selling the old common stock short.

Approach to Analysis of the Plan

Two elements in this situation stood out sharply. Complete liquidation would give the creditors about $0.50 on the dollar, while the equity interests would be wiped out; and potential values in the reorganized company would come mainly from the use of the $3.8 million tax-loss carry-forward. This, and the sale of unprofitable stores, could inject hope for the reorganized company.

The financial statements and reorganization-plan material contained all the needed information. The determining factor was the obvious benefit to be derived from going along with the plan. Opposition did exist, but its position was weak, since no other workable plan had been submitted, nor was one in view.

The Consolidated Retail Stores Corp. reorganization is an illustration of procedures valuable in trading opportunities which often arise in reorganizations. Here it was possible for the informed investor to participate via two kinds of trading positions, namely (1) a straight long position of the old preferred, (2) a hedge position created by selling part or all the common while retaining a long position in the old preferred. The investor's thinking proceeds as follows:

How to Talk It Over with Yourself

If the old common had a nominal value of $1 per share based on the recapitalization and debt adjustment plan (keep in mind that the tax loss gives value to the new equity position), then the new common would be worth $2 per share, since it would be issued at the rate of one-half share for each old common.

The preferred, in effect, would receive nine shares of new common, four shares directly and five shares available upon conversion of the new preferred. Thus, at $2 per share, the nine shares of new common would be worth $18 plus the value of the warrant. As the preferred was available around the $13 to $14 level in August-September, a purchase then of a straight long position would have worked out as follows:

Buy, 100 shares of old preferred at $14, cost	$1,400
At the time the plan was confirmed in October the following transaction was possible:	
Sell, 100 old preferred at $18.5, proceeds	$1,850
Gross profit (duration 2 months)	**$450**

Second example – Hedge Position

Investors would have hedged this situation as follows:

Buy, 100 preferred at $14, cost		$1,400
At the same time:		
Sell, 900 old common short at 2, proceeds	$1,800	
Subsequently,		
Buy, 900 old common at $1, cost	-$900	
Gross Profit	$900	
Sell, 100 old preferred at $18.5, proceeds		$1,850
Gross profit on preferred transaction		$450
Combined profit of short sale and long preferred		**$1,350**

A thought to bear in mind is that the foregoing trading procedures have similar application where an exchange of securities is in operation.

Reversionary Certificates

A **reversionary certificate** gets its name from the turning action it represents. The action can be compared to the return of leased property at the expiration of the lease. The assets behind a Reversionary Certificate would become available after the contingency for which the certificates were created had been met.

The reorganization of the *Georgia RR and Banking Company* established two reversionary-certificates, special situation investments. These reversionary certificates are presently available in the market at prices averaging a fraction of the value of the asset underlying the certificates. However, the assets which are represented by designated shares will not be available to the certificate holders until 1980. Nevertheless, intermediate profit potentials exist through market fluctuations. Then, too, the long-term characteristics of the certificates make them interesting as gifts to children and for speculative holdings by investment companies.

Two reversionary certificate situations came into being in dividends declared by the *Georgia RR and Banking Co.* on July 7, 1954. The individual certificates represent the railroad company's reversionary interest in 12,180 shares of stock of the *Western Railway of Alabama* in one issue and in 7,000 shares of capital stock of the *Atlanta & West RR Co*. in the other issue. The shares are held by the lessees. Dividends and returns are paid to the Railroad Company.

The Western Railway of Alabama

Participating certificates, current market price $8 per share

Capital stock, current market price $75 per share

A *Western Railway of Alabama certificate* is entitled to one share of stock of the railroad company when the reversion becomes effective in 1980. The investor's problem is to establish a value for an asset that will not be available until two decades hence.

The Analytical Approach

The *Western Railway of Alabama* is affiliated with the *Georgia Railroad and Banking Co.* and the *Atlantic Coast Line Railroad*. The road extends from West Point, Ga., to Selma, Ala. The 133 miles of track operate mainly in Alabama. The line forms a connecting link of a through route from Washington, D.C. to Jackson, Miss.

There are 30,000 shares of capital stock. Gross assets amount to $11.7 million. Funded debt totals $1.8 million. Net current assets are $1.2 million.

The earnings record has been good since the company's inception in the early 1900's. The dividend record parallels the good earnings record. Some dividends have been paid in every year since 1902, except for four depression years in the 1930's.

The recent year's price range of the shares was between a high of 108 and a low of 75.

Thus the railroad has (1) valuable track, (2) good earnings, (3) substantial continuing dividends, and (4) large asset value. The investor's thinking might see the present price for the certificates as the knockdown value of the property. On this basis, the loss would be the absence of a return on the investment, while the profit could be substantial in the light of the present value of the actual stock. The investment thinking depends on your conjecture of the future. Should you think that the railroad will not be functioning by 1980, and the property will not have a value even as junk, the certificates would hold no interest.

A point to bear in mind is that the certificates reflect, through the market prices of the shares and the certificates, the company's "going concern" outlook. Three years ago the certificates were available around the $5 level; the present price is $9, and the price has touched the $12.50 level.

Standard Gas & Electric Company: A Tax-suit Stub

The stubs presently are priced around $3 per share on the NYSE. This is a liquidation. The stubs represent an interest in fixed assets and a tax reserve fund. The fixed assets comprise marketable securities and cash amounting to approximately $6.20 per share as of Dec. 31, 1957. From this sum a reserve fund equal to $1.85 per share has been established to meet Federal tax liabilities for prior years, leaving the stubs an estimated minimum worth of around $4.35 per share. Additional value is contingent upon the outcome of the tax case, which is in the Appellate Division of the IRS. Comprehensive information about the tax case is contained in the company's annual report.

Since the probable profit may be estimated at $1.35 gross the situation shows a potential return of 45% on the investment. The tax matters pertain to the years 1942 to 1950, inclusive. While the nature of the tax status is complex, determination must be made. Therefore you could approach this situation looking toward a maximum duration period of four years. This would show a return of 11%. However, you should not lose sight of the tax contingency, which will have the final influence in this case.

Ridgeway Corporation: A Residual Asset

This stub, priced around $8 per share on the Amex, offers participation in a residual asset resulting from a liquidation. The principal asset comprised a tract of 800 undeveloped acres in the vicinity of the International Airport at Miami, FLA. Besides this, there are small holding in the Palm Beach area. Estimated land values indicate a liquidation value around $11.6 per share.

The significant factor here is the duration period, since the stock priced at about a discount of 45% from its expected liquidating value. The trusted, situated in Miami, FL is the most likely source of information about progress toward complete liquidation. The company issues reports showing the cash position, estimated value of land holdings and tax liabilities.

This situation illustrates the significance of sponsorship of a corporate action. Here we have a liquidation procedure controlled by management which has disposed of their stock interest. Since the company is in liquidation, the corporate books are closed and stockholders' meetings are not held. Because of this it is difficult to change management. Nevertheless, from the investor's point of view, it would be worth checking developments since a sale of the major properties would have profit possibilities.

The financial analysis is simple since no contingencies exist. The value of the land, less Federal taxes and the small amount of liabilities, will establish the amount to be divided among the outstanding shares. The acreage can be appraised through Miami real estate firms. The company is the most likely source of background information on finances, tax, and legal matters. The duration period is the point to watch, and this can be checked with the company.

International Paper Co., Certificates of Contingent Interest.

This situation developed a windfall of substantial profits shortly after issuance. The certificates were priced around 20 were first issued and now are selling around 69. These certificates were issued in connection with merger of international paper and long they'll company. Each certificate represents an interest in a user on presently aggregating 38,000 shares of international paper common stock. The fund was established to protect *International Paper* against expenses and lost on account of federal taxes of long they'll company, and a lawsuit brought against that company. His lawsuit has been settled. Attacks matter is that the lower level of court procedure. However, a windfall possibility has come to light in the companies tax refund claim against the government, which could make the company to restate the and rather than the dispenser of bonds. His possibility was reflected in this or that gets sharp rise in price.

At this point of 30,000 shares of *International Paper* held in Bonn have a market value of work .2 million equal to $84 per certificate. This is 33% greater than the market price. Since the situation has had a dramatic change from a participation in a residual asset to a dynamic legal tax matter, some risk element is now present.

The most likely sources for information in this situation are the company and legal affiliates. The annual report. Complete discussion of the background of the certificates. Investigation and checking rather than financial analysis is the procedure.

Recaps & Stub Stocks

In a Recapitalization a company usually buys a large portion of shares back from shareholders.

An example of this is a company trading at $18 that decides to distribute $15 dollars of bonds to investors, at $18 per share we'll assume it earns $1.50 per shares, or a P/E of 12x, taking out the 40% tax rate it is making $2.50. After the recap it should be trading at $3 per share ($18 minus the $15 in bonds), it still earns $2.50 per share, assuming the bonds paid ten percent we first subtract $1.50 from earnings for interest expense, which is tax deductible, to get $1 per share, then multiply it by the 40% tax rate to get $.60 EPS.

If the company is trading at $3 this is a P/E of 5, probably too low. Of course the highly leveraged stub stock (stock after recap) probably doesn't deserve the same P/E as it did before, but if we assume an 8.33 P/E is justifiable – it's has the same business model, the only thing that has changed is the amount of debt - it should trade at $5, giving us a recap package of $20 ($5 stock, plus $15 bonds), this is a gain of 11% from the original $18.

Recaps aren't as popular as they were in the mid '80's, but when you find one *Joel Greenblatt* says, "There is almost no other area of the stock market where research and careful analysis can be rewarded as quickly and generously."

Stub Stocks, Warrants, Options, and LEAPs: Derivatives can make good investments, but leverage cuts both ways. Stub stocks, on the other hand, can make excellent investments. A stub stock is any stock in which the publicly traded shares represent only a small portion of the overall company. Usually, the vast majority are owned by another corporation. Since the majority shareholder is also the controlling shareholder in this case, you can be sure investors' best interests always come first. That doesn't necessarily mean external investors will prosper, but it does increase the odds. As always, pick your spots here.

Porsche Stub Stock

One last post about Greenlight Capital's letter to investors. Below is an excerpt about Porsche AG, who holds a 35% interest in Volkswagen, an investment that is larger than Porsche's current market cap.

The PAH3 stub (symbol formerly POR) fell sharply during the quarter, as PAH3 increased its stake in Volkswagen from ~30% to ~35% and the state of Lower Saxony postured that it would consider increasing its stake from ~20% to ~25% in order to keep its veto rights if the European Union deemed that this was necessary. We believe that these actions are providing an artificial bid for Volkswagen shares in the market place. We also suspect the stub value suffered due to liquidations by other funds including a certain failed investment bank that market participants believe held the stub. On a fundamental basis, we believe that Volkswagen is highly overvalued at 21 times estimated 2009 EPS, more than twice the multiple of its peer group.

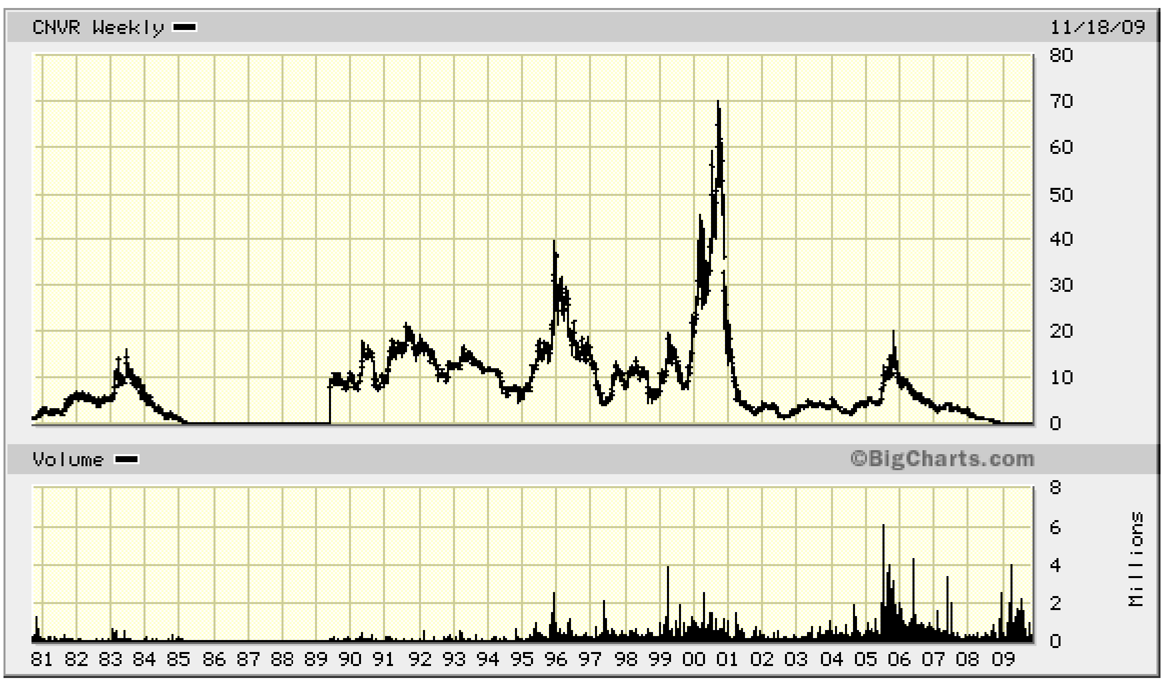
PAH3's market cap is €13.3 billion and it has €4.2 billion of net debt. At current market prices, the company's 35% interest in Volkswagen is worth €28.9 billion.

Example: **Convera Corporation (NASDAQ:CNVR)**

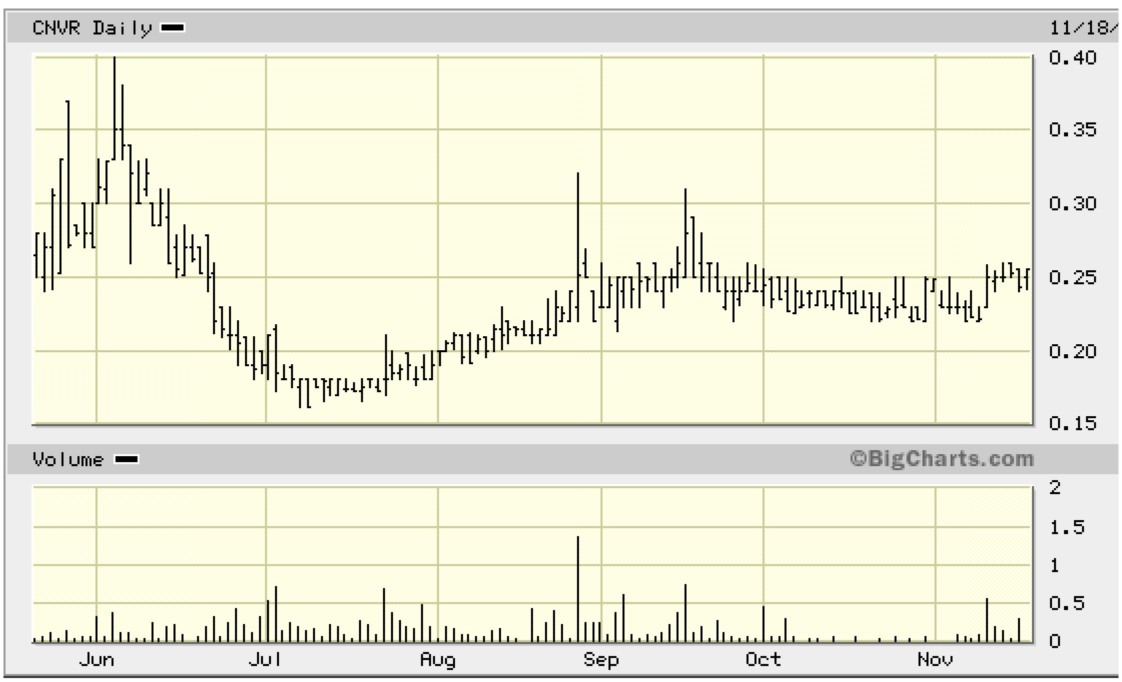
November 11, 2009

Convera Corporation (NASDAQ:CNVR) is a liquidation play. The stock closed yesterday at $0.221. The company estimates the value of the distributions to be in the range of $0.37 to $0.45 per share. You pay out 22 to 24 cents then get back quickly 18 cents and then 4 to 5 cents in six and 12 months—sop you get your money back plus some leaving a free option worth stock in a new company which could be worth $0 or 10 to 20 cents per stub. Little-to-no money at risk and perhaps even payment to hold the "lottery" ticket.

The company has already voted to be liquidated and, most importantly, the majority shareholder, is **Allen & Company** with 20% of the stock. Allen & Company and Herbert Allen are well respected and Mr. Allen sits on the board of Coke. We will ride along with him so we are aligned with the controlling shareholder and in this situation we do not have to worry quite as much about management incentives being contrary to our position




CNVR Daily
11/18/09
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
Volume
©BigCharts.com
3
2
1
0
Millions
D 08 F M A M J J A S O N D 09 F M A M J J A S O N


CNVR Daily
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0.35
0.30
0.25
0.20
0.15
Volume
©BigCharts.com
2
1.5
1
0.5
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Jun Jul Aug Sep Oct Nov

Approvals

According to the 14(c) information statement:

The board approved the plan of dissolution on May 29, 2009. The liquidation will not be put to a shareholder vote as "the affirmative vote of holders of a majority of all outstanding shares of our Class A Common Stock is required. In order to approve the election of directors, the affirmative vote of a plurality of all outstanding shares of our Class A Common Stock is required. As of the close of business on September 22, 2009, the Record Date for the approval of the above matters, there were 53,501,183 shares of our Class A Common Stock issued and outstanding, which shares are entitled to one vote per share. **Holders of our Class A Common Stock which represented a majority of the voting power of our outstanding capital stock as of the Record Date, have executed a written consent in favor of the actions described above and have delivered it to us on September 22, 2009, the Consent Date. Therefore, no other consents will be solicited in connection with this Information Statement.**"

Distributions

From the information statement:

We plan to distribute $10,000,000 shortly after the closing of the Merger, with the remaining $4,000,000 to be distributed in $2,000,000 increments at six months and 12 months after the closing of the Merger, subject to possible holdbacks for potential liabilities and on-going expenses deemed necessary by our board of directors in its sole discretion. $0.261 per share in total.

The present value of this cash distribution, assuming a discount rate of 10%, is estimated at $0.26 per share.

($ in 000)	Cash Balance	Closing	6-Months	12-Months
Cash Remaining in Convera	$ 14,000	$ 10,000	$ 2,000	$ 2,000
Discount Interval		0	0.5	1
Present Value (PV) Factor @ 10%		1.0000	0.9535	0.9091
PV of Cash Distribution		10,000	1,907	1,818
Total PV of Cash Distribution		$ 13,725		
Shares Outstanding (Fully-Diluted)		53,501		
Present Value of Cash Per-Share		$ 0.26		

Hempstead assessed the value indication associated with a one-third equity interest in VSW based upon the discounted cash flows methodology. Specifically, under a discounted cash flows methodology, the value of a company's stock is determined by discounting to present value the expected returns that accrue to holders of such equity. Projected cash flows for VSW were based upon projected financial data prepared by our management. Estimated cash flows to equity holders were discounted to present value based upon a range of discount rates, from 25% to 35%.

This range of discount rates is reflective of the required rates of return on later-stage venture capital investments. The resultant value indications for the VSW component of the transaction, on a per-Convera share basis, are as follows:

Newco Discounted Cash Flows Analysis

Fiscal Year Ended January 31,		2010	2011	2012	2013	2014	Terminal
Equity Net Cash Flow		$ (2,765)	1,688	$ 3,496	$ 8,280	$ 13,934	$ 9,554
Partial Period Adjustment		$ (1,843)					
Discount Interval		0.333	1.167	2.167	3.167	4.167	
Present Value Factor @ 30%		0.92	0.74	0.57	0.44	0.34	
PV of Equity Net Cash Flow		(1,689)	1,243	1,980	3,607	4,670	
PV of Discrete Period		**9,812**					
Terminal Cash Flow	9,554						
Terminal Multiple: 1/ (.30 – .05)	4						
Terminal Value	38,216						
PV Factor	0.34						
Present Value of Terminal Value		12,808					
Aggregate Equity Value		22,620		**Discount Rate**	**Per-Share Value**		
33.3% of Aggregate Equity Value		7,540					
Convera Shares Outstanding		53,501		25%	$ 0.19		
				30%	$ 0.14		
VSW Value Per Convera Share		$ 0.14		35%	$ 0.11		

Based upon the above analyses, the value indications for the cash and VSW stock to be received by our stockholders in exchange for their current Convera shares are within a range of $0.37 to $0.45 per Convera share.

Conclusion

The trading price of the VSW stock is an unknown, but the $0.26 in cash distributions offer some protection at yesterday's close of $0.221. Buying up to say $0.24 means getting paid $0.02 to hold a **free option on the VSW stock**, which, according to Hempstead, the financial consultant providing the fairness opinion, could be worth between $0.11 and $0.19 per share. It's very thinly traded at this price.

The S&P500 closed yesterday at 1,093.01.