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# SCHIFF'S

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# Conseco is Bankrupt—Finally!

## *Long Time Coming*

It can take some time for a big, sleazy company to go bust. And it can take even longer when that company is run by a avaricious mountebank assisted by a bunkum-spewing accountant skilled in numerical prestidigitation.

Yeserday, Conseco, Inc. filed a voluntary petition for reorganization under Chapter 11. Measured by assets ($52 billion) Conseco is the third-largest bankruptcy of all time. The Chapter 11 filing brings to a close at least one part of Conseco's history—that of grand pronouncements and go-go financial deals.

For a decade or so, Conseco conjured up magnificent "earnings," some of which were non-recurring and much of which were illusory. *Schiff's* has been a long-time bear on Conseco. The first of our many negative articles appeared in March 1994. Regardless of what Conseco's numbers looked like—and they always appeared dubious to us—Stephen Hilbert, chairman and C.E.O., was even worse. "Despite his bland looks, balding pate, and oversized glasses, Hilbert is a flashy promoter," we wrote in 1994. "He sports $3,500 Bijan suits, gets around in Conseco's corporate jet, and, when delivering his smooth, polished sales pitch, speaks with an air of *absolute* certainty. He brashly projects huge growth rates for his companies—which he says are a 'vehicle' (pronounced '*vee*-hickle') for capital gains. To some, Hilbert's bravura performance inspires confidence...Others see false humility and the silver-tongued spiel of a side-show shaman."

Conseco's most distinguished skeptic has been Abraham J. Briloff, now 84. Briloff, a certified public accountant, professor, and eloquent author, is a longtime critic of the accounting industry and of companies that employ aggressive, misleading, or inconsistent accounting. (*Schiff's* has been deeply influenced by Briloff's books—*Unaccountable Accounting*, *The Truth About Corporate Accounting*, and *More Debits Than Credits*—all of which, sadly, have been out of print for two decades or more.) Briloff, who spoke at *Schiff's Insurance Conference* last year, dissected Conseco in the early 1990s and never let up, despite legal threats from Conseco as well as preposterous accusations that he was in cahoots with shortsellers.


*Conseco's former C.E.O., Stephen Hilbert, in 1995*

Over the years, others who looked at Conseco and came to the conclusion that it was an accident waiting to happen were attacked by the company, which generally labeled them as shortsellers spreading misinformation for personal gain. When that approach wasn't possible, Conseco resorted to other means.

In October 1994, Merrill Lynch analyst Ed Spehar downgraded Conseco from "strong buy" to "buy." Conseco promptly fired Merrill as underwriter for an offering of convertible bonds. (Conseco claimed that the downgrade had nothing to do with its decision.) Merrill, for its part, said it was sticking by Spehar. But losing a highly acquisitive, transaction-oriented life-insurance organization could not have sat well with Merrill. The following summer, as fate would have it, Spehar was—you guessed it!—no longer employed at Merrill. One week after Spehar's departure an amazing coincidence occurred: Conseco hired Merrill as underwriter for the 15,000,000-share offering of one of its subsidiaries. (Spehar returned to Merrill Lynch some years later.)

In June 2000, after a torrent of losses, Hilbert, a consummate huckster who gives consummate hucksters a bad name, was replaced by Gary Wendt, who'd been the big man at GE Capital. One would have expected that Wendt, a six-sigma disciple, would dispatch the shameless hype and shortselling accusations that were a hallmark of the Hilbert era.

Although Wendt is smarter and more polished than Hilbert, he turned out to have many of the same Wizard-of-Oz characteristics. He accelerated Conseco Finance's growth (a big mistake) and blew many opportunities to de-lever the parent company. He issued wildly bullish "turn-around" memos as well as a steady stream of rosy press releases which temporarily propped up Conseco's worthless stock. Like Hilbert, he tended to view critics as nefarious shortsellers. "We believe that shortsellers and other persons have been disseminating misleading information about Conseco's upcoming debt maturation," the company stated in an August 17, 2000 press release.

On June 1, 2001 a Conseco press release smeared a series of critical articles written by *TheStreet.com*'s Peter Eavis: "Conseco's investors have become accustomed to these periodic attacks. Over the past nine months, *TheStreet.com* has essentially behaved as the house publication for the short sellers in our stock...So long as there are people out there staring at multi-million dollar losses in their short positions, there will be a powerful incentive for this kind of propaganda...Therefore, we will continue to answer absurd claims until there is no longer an upside in misinformation."

Although *Schiff's* had published many long, critical articles about Conseco over the years, much to our chagrin we never made it onto Conseco's "enemies list." Colin Devine, vice president and insurance analyst at Salomon Smith Barney, did, however. In January 1999 he cut his rating on Conseco's stock, then selling for $37, from "outperform" to "neutral." He then became increasingly negative. Conseco eventually lashed out at him, branding his work "inflammatory" and "inaccurate." Irwin Jacobs, a one-time corporate raider who then owned 16 million Conseco shares, called Devine a tool of the shortsellers and took out full-page ads in *The Wall Street Journal* lambasting him.

*Schiff's*, of course, was a fan of Devine. Most analysts would never issue negative research reports—they're too afraid. Devine, however, had guts. He was bold and right, and we admired his stance. In April 2000, Devine spoke at our annual conference and discussed, among other topics, Conseco's financial problems. (For the record: partly on the strength of his Conseco research, Devine was subsequently selected as *Institutional Investor*'s "All American" life insurance analyst.)

Although Conseco's bankruptcy filing was not a surprise, over the years the magnitude of its problems surprised many who shouldn't have been surprised. Conseco's failure was not inevitable, but a profusion of warning signals had been in plain sight for more than a decade. These, as well as Hilbert's character (or lack thereof), *should* have frightened off all but the most hardcore speculators—but they didn't. That, of course, is what makes markets. Where one person sees risk another sees reward.

Conseco's history is worth pondering, if only for a moment. The company's Big Idea, if one chooses to call it that, was to do an LBO of a life-insurance company. It's second Big Idea was to do increasingly large life-insurance LBOs. Throwing a bunch of life insurance companies together under one corporate parent is supposed to create "synergy." Conseco's final Big Idea was to use its hyped-up stock to acquire Green Tree, a subprime lender, especially for manufactured homes. As everyone knows, there are great synergies between hawking overpriced life-insurance products and lending money to people who often cannot keep up the payments on their loans.

If Conseco's wheeling and dealing didn't scare you, its aggressive accounting should have. The company performed magical feats that demonstrated that its hand was quicker than most people's eyes. Conseco purchased life insurance companies with almost no money down. It made stock acquisitions. It did poolings. It used purchase accounting. It sold off partial interests in subsidiaries to the public. It bought back some of these subsidiaries' shares. It repurchased its own stock. It repurchased its shares through its insurance-company subsidiaries. It sold companies. It repurchased spun-off companies. It managed an LBO fund that bought life-insurance companies. It granted giant reload stock-option packages to its executives and then, when the options were deep in the money, repurchased the exercised shares from the executives at prices that were higher than the executives would have gotten in the open market. It borrowed money and issued preferred stock. It made loans to its executives. It guaranteed giant loans to its executives—without receiving sufficient collateral—enabling the executives to buy loads of Conseco stock.

Conseco shifted its accounting methods often enough so that even the most learned accountant would have had trouble tracking one year's results versus another's. Sometimes it carried insurance subsidiaries on its balance sheet on the equity basis (showing an entry for the value of the subsidiary); at other times it used a consolidated basis (showing the assets and liabilities of the subsidiary com-


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bined with the company's other assets and liabilities). Conseco recognized income when a partially-owned subsidiary, Bankers Life, issued stock, even though none of the proceeds went to Conseco, yet it didn't reverse that bookkeeping "income" when, a short while later, it purchased Bankers' stock at prices higher than that which Bankers had issued shares. (See *Schiff's Insurance Observer*, April 1995, page 4-8.)

Conseco's growth strategy was perched on a two-legged stool of leverage and acquisitions. Conseco is an amalgam of mediocre life insurance companies, most of which were acquired in leveraged transactions. Conseco Finance Corp. (formerly Green Tree), which was acquired for stock in 1998, had suspicious looking financials even before it was acquired by Conseco. It had a history of reporting good earnings and then taking big write-offs which negated the previously reported profits.

One who dislikes leverage, aggressive accounting, financial legerdemain, and hyper-growth would probably have shunned Conseco's stock *at any price*. The underlying bearish case on Conseco remained pretty much the same forever—that the company's financial opacity masked a risky business, and that its reported and projected "earnings" were meaningless because the company's accounting methods—*even if they did conform to GAAP*—were as smelly as a piece of Roquefort that had been sitting out all week. The bears posited that some day a cash squeeze could bring down the parent company. (The parent relied heavily on its insurance subsidiaries' ability to upstream enough dividends, fees, or interest to permit the parent to service its obligations.)

High leverage, rapid growth, and fancy accounting don't mix well with insurance. Given enough time, these ingredients will almost always wreak havoc.

Yesterday, the official game clock ran out for Conseco. ■