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Deals & Deal Makers: Grubman Touted Winstar, Even as It Was Sinking
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Salomon Smith Barney star analyst Jack Grubman went to great lengths to bolster Winstar Communications Inc., even as the telecom-stock bubble began bursting last year.

Mr. Grubman didn't just pepper investors with research notes supporting the company, which provided phone and high-speed data services to companies and government agencies: The 49-year-old analyst also gave management advice on how to shore up Winstar's balance sheet. When investors attacked Winstar's finances, Mr. Grubman attacked the critics, issuing detailed responses to a short-seller and a rival brokerage analyst, who early last year began to raise serious questions about the stock.

Now, it is stock regulators who are raising questions about Mr. Grubman. As disclosed in yesterday's Wall Street Journal, the regulatory arm of the National Association of Securities Dealers is preparing to take regulatory action against Mr. Grubman and his firm, Salomon Smith Barney, over his Winstar actions. The NASD is considering a range of allegations against both Mr. Grubman and the Citigroup Inc. unit, people close to the matter say, including securities fraud and violations of NASD rules that bar analysts from making misleading statements to investors for his research on Winstar.

Mr. Grubman's problems might not end there. New York state Attorney General Eliot Spitzer is considering civil or possibly criminal charges against Mr. Grubman for misleading small investors with overly optimistic research on companies that also gave Salomon Smith Barney investment-banking business, people familiar with the matter say. Some senior officials in the state attorney general's office are ready to bring charges against Mr. Grubman, but Mr. Spitzer hasn't made a final call. Meanwhile, the U.S. attorney in Manhattan has joined state and federal regulators investigating the research activities at Salomon Smith Barney, including the work of Mr. Grubman, people close to that matter say.

Mr. Grubman didn't return a telephone call for comment, and a Salomon Smith Barney spokeswoman said, "As always, we will cooperate with any inquiry." She said, "Mr. Grubman's calls on Winstar were part of a consistent and reasonable investment thesis held in good faith for many years. There was no intent to mislead investors."

Mr. Grubman's involvement in Winstar underscores his unique brand of corporate research. While other analysts were content to issue reports on companies -- the vast majority of them positive as their firms fought to win underwriting business from these very same corporations -- Mr. Grubman at times got more directly involved.

Consider his battle with a high-profile investor on Winstar. In early March 2001, Manuel Asensio, a highly visible short-seller, issued a report saying that Winstar "will have to be restructured to have any chance of funding its continuing operating losses." Mr. Grubman wasted little time striking back. He issued a report the next day calling into question Mr. Asensio's research, and, according to Mr. Asensio, rounding up big Winstar investors, telling them to ignore the short-seller's opinion and keep the faith with Winstar.

"I know he told money managers that he would discredit everything I said," Mr. Asensio recalled in an interview yesterday. "I went to Jack Grubman myself and personally left messages, sent him faxes and wrote him letters" about his research on the company. "I said this thing was going to file [for bankruptcy]. But he did something unusual by attacking me personally, which is a rare thing because guys like him usually ignore us."

For a while, Mr. Grubman's research strategy worked. And in the process, Mr. Grubman became wealthy; he recently told congressional investigators that he received an average annual pay package of $20 million in recent years, thanks in part to his ability to help his firm win lucrative investment-banking business. In the end, however, the tactics backfired; within weeks of his run-in with Mr. Asensio, Winstar filed for Chapter 11 bankruptcy protection.

In its heyday in the late 1990s, Winstar was regarded as just the kind of New Age company that could bring competition to the recently deregulated telecommunications industry. Mounting dish antennas on office buildings around the country, Winstar hoped to harness a rarely used wireless frequency to hook up phone and Internet connections for business customers in more than 125 U.S. markets.

When initiating coverage on Winstar in January 1998, Mr. Grubman called the company "compelling," and noted that Winstar's services were running at a 15% discount to local Bell companies. With Winstar's quarterly revenue growing 18%, Mr. Grubman said in February 2000 that the company's results exceeded his expectations and raised the stock's price target from $86 to $100.

Winstar shares hit a record high of $66.50 in March 2000, with its market capitalization hitting $10 billion. During the bubble's peak, the company and its kind were Wall Street darlings, easily able to tap the capital markets through debt and equity offerings. But as the markets fell off, so too did Winstar's opportunities to raise capital that the company needed badly not just to build its networks but also to meet day-to-day obligations.

Winstar executives resorted to trying to raise several hundred million dollars by selling chunks of unused capacity on its nationwide broadband network. There were no takers. Among the companies that took the biggest bath on Winstar were "vendor financiers" such as Lucent Technologies Inc., which had loaned Winstar more than $600 million, part of which Winstar had been using to pay general and administrative expenses in addition to buying Lucent telecom equipment.

Winstar also was one of the first companies to engage in the type of fiber "swap" transactions that have become so controversial over the past year in the wake of Global Crossing Ltd.'s collapse. Starting in 1998, for instance, Winstar signed a series of contracts with Williams Communications Group Inc., in which Williams agreed to pay Winstar $400 million over four years for access to its portions of its telecom network. Winstar then turned around and agreed to pay Williams $644 million over seven years.

Winstar's collapse in early 2001 marked a watershed event for the telecom sector. It became among the first -- and most heavily financed -- competing local exchange carriers to file for bankruptcy protection and in the process exposed deep flaws in the industry's prevailing capital structures and financing mechanisms.

Despite assets that the company valued at more than $5 billion, Winstar was sold in December for just $42.5 million, to IDT Corp., a New Jersey telecommunications firm.

Among Wall Street analysts, Mr. Grubman's unbridled optimism for Winstar throughout was the rule rather than the exception, though his opinions carried far more weight than that of most others. By March 30, 2001, when Winstar stock languished at $2.16 a share, all but one of the 20 analysts following the stock had some form of a "buy" rating; the other had a "hold." Among those analysts reporting near-term price targets at the time, the average was still around $40, according to Thomson First Call.

In an interview that day, Mr. Grubman said he stood by his $50 12-to-18-month "speculative buy" rating and price target, which he had stated in a March 21 research report, where he wrote that "Winstar has done a superb job in gaining traction in its business."