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CEO Schimmelbusch Cited As a Reason for Timminco Short Sale

Francois Parenteau, a Canadian hedge fund manager, has taken a short position in Timminco Limited (TSX: TIM $21.23), as he stated in an interview with Value Investor Insight published July 31. Parenteau discusses five reasons for skepticism about Timminco. He states that "[Timminco's] CEO is a guy named Heinz Schimmelbusch, who was the CEO of the German conglomerate Metallgesellschaft when it almost went bankrupt after losing a huge amount of money on speculative bets on oil futures." For the full Value Investor Insight article, click here.

Scrutiny of publicly available documents reveals that the losses at Metallgesellschaft AG ("MG") were not limited only to "speculative bets on oil futures." MG also sustained large losses related to its investment in an oil refinery through a relationship with a publicly traded U.S. micro-cap, Castle Energy Corp. ("Castle").

Heinz Schimmelbusch was Chairman of the Executive Board at MG when it initiated a relationship with Castle in 1989. He remained Chairman, until MG, nearly bankrupt as a result of losses sustained in a series of controversial dealings, fired him in 1993 Of MG's $1.6 billion in total irregular losses, approximately $685 million, or 41%, resulted from MG’s relationship with Castle (See Exhibit A, pages 1 and 5).

MG was a company with $16 billion in annual revenues. (See Exhibit B). Castle, on the other hand, only had a book value of $7 million, a market capitalization of approximately $9.3 million (total enterprise value of $12.1 million), and annual revenues of $6.5 million in 1988, prior to its involvement with MG. (See Exhibit C). Castle's primary business was the management of limited partnerships in oil and gas production.

In 1989 Castle purchased an oil refining plant, the Indian Refinery, which had been shut down by Texaco in 1985. Castle paid $5 million in cash for the refinery (See Exhibit D). According to a certified English translation of an action filed by MG against Schimmelbusch in Frankfurt in February 1995, which was filed by MG in a related lawsuit brought by Schimmelbusch in New York, MG Corp. provided Castle with the cash for the purchase of the refinery through stock purchases (See Exhibit A, page 3). MG also made a commitment to "obtain or itself provide…a letter of credit facility" for the refinery's feedstock, as stated in Castle's 1989 10-K (See Exhibit E). In 1990, MG provided $32 million of financing for the refinery's startup costs (See Exhibit F).

Castle had not been involved in the oil refining business prior to the acquisition. However, Castle management stated in 1989 that it expected 90 to 95% of the company's future revenues to come from refining, once the refinery was operational (See Exhibit G).

Castle's refining operations lasted from 1990 to 1995. In addition to the Indian Refinery, Castle acquired another refinery, the Powerine Refinery, in 1993 from MG (See Exhibit H). MG signed Offtake Agreements to buy Castle's refinery output, where "the prices received by Powerine and IRLP [Indian Refinery] for their refined product output under the Offtake Agreements were significantly higher than the prices that would have been obtainable selling refined products in the market…the refining segment would have incurred a loss for fiscal 1994 absent the Offtake Agreements"

(See Exhibit I).

The Offtake Agreements created losses for MG and profits for Castle (See Exhibit A, page 2). In 1994 MG reached a settlement with Castle to end their relationship and to terminate the Offtake Agreements. Castle stopped operating both refineries in 1995 (See Exhibit H).

Castle’s revenues from MG totaled approximately $1.8 billion from 1991 to 1994 (See Exhibit J). This represents 87% of Castle’s total revenue over the same period. The cumulative income Castle received on sales to MG amounted to $376 million (See Exhibit J). Castle reported a separate $396 million "Gain on MG Settlement" on its 1995 Cash Flow Statement (See Exhibit K). This amounts to a total direct gain for Castle in its MG dealings of approximately $772 million during the five year period it was involved with MG (See Exhibit J).

Castle listed the value of its refining plants at $295 million in its 1994 balance sheet. After the 1994 settlement with MG, Castle wrote down the value of the refining plant to $10.8 million, listed as the "estimated realizable value" (See Exhibit K). The settlement extinguished Castle's debt to MG (See Exhibit C). Castle’s long-term liabilities decreased by $310 million from 1994 to 1995 (See Exhibit K). MG also surrendered to Castle approximately 4.6 million shares of Castle stock (See Exhibit L). Beyond this, Castle received a $10 million note from MG (See Exhibit K). MG was thus able to extract itself from its relationship with Castle.

Castle's stock price rose sharply when the involvement with MG started. The price per share went from a low of $2.50 at the start of 1989 to $9.25 at the end of 1989 (See Exhibit M). By 1994, the stock price had gone to a high of $25.00 per share (See Exhibit N).

In 1994 Castle's enterprise value reached $556 million. In 1995, following the settlement with MG, Castle's enterprise value went down to $109.6 million.

MG’s action alleges "an express quid pro quo" for the signing of the Offtake Agreements with the granting of options on Castle stock to MG employees. The action states that Castle issued 600,000 options to four employees of MG’s U.S. entities (See Exhibit A, page 4).

According to MG's action, MG had a direct loss of $423.1 million from the settlement with Castle and $262.5 million from the Offtake Agreements with Castle (See Exhibit A, page 5). Thus MG's total losses from involvement with Castle amounted to $685.6 million.

To view the exhibits, click here.