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July 27, 2016

Via U.S. Mail

Ontario Securities Commission
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Toronto, ON
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Associate Director, Division of Enforcement
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Office of the Whistleblower
Securities and Exchange Commission
100 F Street NE
Mail Stop 5631
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Board of Directors
Concordia International Corp
277 Lakeshore Road East, Suite 302
Oakville, Ontario
L6J 1H9

Re: An Open Letter to the Ontario Securities Commission, the U.S. Securities and Exchange Commission, and the Board of Directors of Concordia International.

On April 29, 2016, I was interviewed by Frances Horodelski, a reporter for Business News Network (BNN). Ms. Horodelski started the interview by quoting something that Mark Thompson, Concordia International Corp.'s CEO, said that day at the company's annual general meeting: "If you are a chicken farmer, your chickens will come home to roost."

As Ms. Horodelski correctly observed, that public comment was "directed very specifically" at me. I've got a farm in California and raise chickens. I also research companies, make investments based on my research, and share what I've found with the public and securities regulators. I don't run a fund; I don't have investors; I'm just a single person interested in the marketplace, with a focus on companies whose share prices don't reflect their true value.

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In my past, I have shared information I developed with the public and regulators about notorious companies engaged in fraudulent accounting and business practices, such as Lernout & Hauspie, Media Vision Technology, and NovaStar Financial. The Harvard Business School published a case study about my efforts in *NovaStar Financial: A Short Seller's Battle* in March 2013 (http://www.hbs.edu/faculty/Pages/item.aspx?num=44503) (copy enclosed as Exhibit 1).

Saying someone's "chickens will come home to roost" is an expression from Chaucer's *Parson's Tale*, written in 1390, and it means a man's bad deeds will come back to haunt him – a kind of threat. Mr. Thompson therefore claimed publicly that I lied, and he was referring to my criticism of Concordia's business in a 2015 interview by Graham & Doddsville, Issue 27 (an investment newsletter published by the Columbia Business School) where I said that Concordia was overleveraged and its management seemed lost.[1]

In response to her request for my reaction to Mr. Thompson's "chicken" comment, I told Ms. Horodelski that, "I bet the jockey and not the horse."[2] I used my experience with Biovail as a reference point. I explained that I had a short position in Biovail. In 2006, Biovail's management sued some of its critics (not me) to try to stifle them, and cost innocent people a lot of money in legal fees and lost time. But then in 2008, the OSC and SEC blew the whistle on Biovail and its management and sued them for accounting fraud and material misstatements. When the truth about Biovail was revealed, its lawsuit against critics crumbled, and Biovail's new management ultimately paid $10 million to its critics to settle the critics' malicious prosecution lawsuit. Biovail's new management admitted that its lawsuits against critics was "regrettable." http://ir.valeant.com/news-releases/2010/04-11-2010b (Biovail became Valeant through a merger).

I told BNN that the management of Concordia had a "past gig" at Biovail, and Thompson has a "history of nonsense" because of his association with Biovail. The "nonsense" to which I referred was the nonsensical tactic of attacking one's critics: that tactic detracts from a manager's job to properly run his business and only brings more scrutiny on the manager.

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[1] My full quote in the Columbia interview was as follows: "I have been involved in what I call the 'Poor Man's Valeant' and that is Concordia Healthcare. They are more levered than VRX and their strategy is being run by ex-Biovail guys who to me are in way over their heads. They have overpaid for acquisitions and have recently missed numbers. I don't think their assets are worth the debt by a long shot and they seem more than lost. They are concerned about the shorts and have lost focus in running their overleveraged business. Their conference call transcripts given their leverage levels are worth a listen."

[2] A transcript of the entire interview is enclosed as Exhibit 2.

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Mr. Thompson was the Associate General Counsel at Biovail under Eugene Melnyk. Biovail's new management euphemistically referred to Melnyk as the person who played a "central role in creating the operating, financial and legal challenges" that the board had to address.[3] That included paying damages to Biovail's critics because of Biovail's false allegations about investors who had criticized Biovail.

In about June 2008, Melnyk (who was still a large shareholder of Biovail) proposed a slate of his own candidates for the board, including Mark Thompson. The proxy statement is enclosed as Exhibit 3.

I suggested in my interview with BNN that Mr. Thompson "focus a little more on running his business and a little less on me." In other words, don't employ the same "best defense is a good offense" tactic of suing a company's critics in the face of solid doubts about the company.

Why have I been critical of Concordia? Concordia is a company that modeled itself on Valeant (a company devoted to inflating the sales price of long-established drugs) and has done so in a way that hurts its shareholders: it incurred huge debt to buy up companies and prescription drugs that sold for modest amounts, with the hope of earning large profits by increasing the price of these well-established drugs by 1000% or more. According to Mr. Thompson, this business model would work because the company would increase prices with little or no reduction in sales. That turns out not to be true. In its 2015 audited financial statements, Concordia reported that drug sales in the United States fell dramatically (by 18.1%) from the third quarter.

My research also revealed that Concordia may have used, or reversed, reserve accounts in ways that made it appear that Concordia's revenues were better than they really were in the last two years. Accounts receivable have increased dramatically in the last two years, which is a troubling sign for a company selling supposedly well-established prescription drugs. Concordia has had two different auditing firms in the last few years and replaced its CFO with someone who was the CFO at Biovail – these are signs of possible instability and disagreements with those responsible to prepare and review the company's financial statements.

Why do I write this letter? In July 2016, Mr. Thompson sued me for defamation for my comments to BNN in the Superior Court in Toronto.[4] Mr. Thompson knows that he would have no chance of winning a defamation case against me in the United States because what I said was true, I was speaking about a matter of public concern, and I spoke about managers of Concordia who chose to become public figures regarding their company. So Mr. Thompson evidently believes that he can silence his and Concordia's

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[3] https://www.sec.gov/Archives/edgar/data/885590/000104746908007270/a2186206zex-99_1.htm (enclosed with this letter as Exhibit 3).

[4] A copy of Thompson's complaint is enclosed as Exhibit 4.

critics through a lawsuit – just like the managers of Biovail (and other companies) have done over the years.

Mr. Thompson figures he has a better chance of winning in Canada – even though Canada's law protects people who speak the truth – or he figures that I won't bother to engage in a lawsuit in a foreign country. I've written this letter to notify regulators and Concordia's Board of Directors about Mr. Thompson's tactic of threatening critics in an effort to silence them.

The Ontario Securities Commission has a new whistleblower provision. Like the American law on the same subject, it protects employees from employers who retaliate against them for exposing fraud. I'm not an employee of Concordia, but I have, on occasion, been a shareholder. More important though is the principle behind the OSC's whistleblower rule: it wants to stop the bullying, threats, and lawsuits by rich managers of marginal companies who love good publicity, but hate any negative criticism.

Seven years ago, SEC Chairman Cox said that the SEC would address analyst bullying by companies. SEC to Tackle Analyst Bullying, http://www.wsj.com/articles/SB112743790387049473?cb=logged0.6950039463117719. The SEC even has a rule (Rule 27F-17) that prohibits any person from taking any action to "impede an individual from communicating directly with the Commission staff about a possible securities law violation."

I ask you – the regulators and Directors who oversee Concordia – to take action to stop Mr. Thompson from trying to intimidate his company's critics. I believe in the free flow of information and opinion about businesses. Without it, investors who don't have the time or skill to research financial statements fly blind; they make investment decisions based on the thinnest knowledge and evidence. Mr. Thompson's tactics deprive investors of healthy discussions about businesses and share prices. If Mr. Thompson goes on unrestrained, then people will suffer more than they already have.

Very truly yours,

Marc Cohodes

EXHIBIT 1

HARVARD | BUSINESS | SCHOOL

-XXXXXX
MARCH 13, 2013

SURAJ SRINIVASAN
AMY KASER

NovaStar - A Short Seller's Battle

On February 21, 2007, Marc Cohodes, a general partner at New York based hedge fund Rocker Partners, breathed a sigh of relief. NovaStar Financial Inc.'s stock had closed at $40.40, 42% down from the previous day's close. It appeared that NovaStar's stock, which Cohodes had been short selling for four tumultuous years, was finally cracking (see **Exhibit 1** for background on short selling). Cohodes began betting against NovaStar in 2003 when the shares were trading around $45. After years of tracking the company's financials, Cohodes had found numerous red flags. He was convinced that NovaStar was manipulating earnings, misleading investors, and was the perpetrator of multiple sources of fraud.

Cohodes began a correspondence with the SEC about NovaStar in February of 2003. He also contacted the press, extensively outlining his suspicions about NovaStar. In the meantime, Cohodes watched as the stock crossed $100, $200, and eventually $250. As he recalled, "the housing market went from hot to crazy to nuts…my losses were horrific and the pressure was enormous and excruciating."[1] Cohodes endured endless questioning by colleagues, a large investor pulled out of his fund specifically because of NovaStar, and he was vilified on websites run by NovaStar's supporters.

But Cohodes never wavered. He was convinced that NovaStar would fail. Each night when he went to bed he recalls telling himself, "tomorrow will be the last day that this company is going to trade."[2] To see that happen took longer and cost more than Cohodes had ever thought.

NovaStar

Background

NovaStar was founded in 1996 by Scott Hartman and Lance Anderson. In the early 1990's the two had worked together at Resource Mortgage Capital.[3] Hartman headed risk management while Anderson was the president of the single-family home mortgage operation. When the company was sold in 1996, Hartman and Anderson decided to start their own company with Hartman as the CEO and Anderson as the COO. Hartman managed the financial operation and dealings with Wall Street, leaving Anderson to oversee hiring, branch openings and NovaStar's expansion.[4]

NovaStar offered a wide range of mortgage loan products to sub-prime borrowers (See **Exhibit 2** for background on sub-prime mortgage industry). They operated through three segments — mortgage lending and loan servicing, mortgage portfolio management and branch operations. In

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Professor Suraj Srinivasan and Research Associate Amy Kaser prepared this case with assistance from Research Associate Kelly Baker. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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mortgage lending and loan servicing, the company generated earnings through fee income and gain on sales of mortgages. Profitability was driven by several factors: origination volumes; spread income: the difference between the interest income generated by a mortgage minus the costs of hedging, servicing, and funding; and gain on sale margins which were affected by the valuations of loans and loan components that were sold.

Risks included credit losses in the portfolio, the interest rate risk associated with lending at long durations and borrowing with short term funds, collateral risk which was driven by housing prices, and the ability to obtain mortgage insurance to mitigate the risk of credit losses. In the mortgage portfolio management division the primary source of earnings was income generated from the return on mortgage securities and their mortgage loan portfolio.

Origination

NovaStar originated loans throughout the U.S. through a network that included wholesale loan brokers and direct to consumer operations. They also had relationships with correspondent institutions from whom they purchased nonconforming mortgage loans. Their direct to consumer origination channel consisted of call centers, which used telemarketing and internet loan lead sources to originate mortgage loans.

In 1999, Novastar opened their retail mortgage broker business, NovaStar Home Mortgage, Inc. (NHMI) which was their network of branch offices throughout the U.S. Branch offices offered conforming and nonconforming loans to potential borrowers. By 2004 NovaStar had over 600 branches. (**Exhibit 3** presents the structure of the mortgage origination industry in which NovaStar operated and their production including nonconforming and conforming during 2004).

The loans NovaStar originated and purchased were sold, either in securitization transactions or in whole loan sales to third parties. This gave NovaStar capital to reinvest and grow their business. In the securitization process, the underlying mortgage assets were separated into tranches and rated by credit rating agencies. Tranches rated AAA through BBB were issued to the public while NovaStar typically retained the interest-only, prepayment penalty, overcollateralization, and other subordinated tranches. NovaStar structured their securitizations so that control over the collateral was transferred and the transfer was accounted for as a sale and a gain was recognized on the sale. This was known as gain on sale accounting. (See **Exhibit 4** for background on securitization and gain on sale accounting).

Servicing

Through their servicing platform, NovaStar serviced the mortgage loans that they originated and purchased. They retained the mortgage servicing rights (MSRs) of the loans that they sold in securitizations. Mortgage servicing yielded fee income in the form of fees paid by the borrowers for normal customer service and processing fees. Typical fees were roughly 0.50% of the outstanding balance. Novastar's management described in the 2004 10-K "The servicing function is critical to the management of credit risk (risk of borrower default and the related economic loss) within our mortgage portfolio."[5]

Mortgage Portfolio Management

NovaStar managed a loan servicing portfolio that grew from around $1.0 billion in 2000 to around $17 billion by the end of 2006 (see **Exhibit 5** and **Exhibit 6** for historic information on portfolio size).[6] Income from the portfolio consisted of the cash flows generated by the mortgages held—including

the interest spread between the coupon on the underlying loan and the cost of financing—and prepayment penalties received from borrowers who paid off their loans before maturity. Earnings were driven by the volume of nonconforming loans as well as the performance of those loans, including their average coupon, credit losses, and prepayment speed.

REIT Status

NovaStar was structured as a real estate investment trust (REIT). As a REIT, NovaStar was not subject to federal income tax on the amount of income or gain that was distributed to shareholders. To qualify for REIT status, 75% of assets had to be invested in real estate and 75% of revenues had to be generated from real estate-related activities. REIT's were allowed to own a taxable subsidiary (TRS). A TRS could hold assets that a REIT could not hold directly and could engage in any real estate or non-real estate related business. Activity at the TRS level was subject to federal and state corporate income taxes. REITs were able to own a TRS as long as the total assets of the TRS did not exceed 20% of the total assets of the enterprise. NovaStar used its TRS to originate, fund, and securitize mortgages. In securitization transactions accounted for as sales, the TRS sold mortgage assets to NovaStar Financial, the REIT, and recognized gain on sales of those mortgage assets at the TRS level. The REIT retained mortgage securities including interest-only, prepayment penalty, overcollateralization and other subordinated mortgage securities.

Marc Cohodes

While attending Babson College in the early 1980's, Marc Cohodes invested in Data Access Systems, a fast-growing computer leasing company that he felt was undervalued.[7] Cohodes believed so strongly in the stock he told friends about it and they invested along with him. The investment started out strong. An article in the *Philadelphia Inquirer* in 1981 commented that, "fast is probably too mild a word to describe the growth"[8] of Data Access Systems, as sales jumped by 33% to $37 million in 1980. The stock that year was up 217%.

It was eventually found to be a fraud, however, which resulted in the 1984 conviction of President and CEO Gerald Cicconi on charges of proxy fraud, interstate transportation of stolen securities and filing a false income tax return. Cicconi was also convicted in 1981 on federal changes that he had been part of a scheme to fraudulently divert money from another company he was involved in, Video Systems Inc. The indictment alleged he and others involved with the company had checks drawn on company accounts and then converted them to their personal use. Cohodes lost about 30% of his investment on Data Access Systems, but thought it worse that he had also lost the money of friends who had invested along with him.[9] This shaped Cohodes' belief that, "there is no worse crime than ripping someone off or deceiving someone out of their hard-earned money."[10]

After graduating with a Bachelor of Finance in 1982, Cohodes began his career in the investment business managing high net worth client assets at Northern Trust in Chicago. It was a horrible economy at the time, but Cohodes recalled he was "so bullish I couldn't see straight."[11] For this reason he found himself continually on the outside of what he referred to as "groupthink"— his opinions were almost always contrarian to those of everyone he worked with, and he felt they "didn't like people who were outliers."[12]

Looking to move on, Cohodes decided to get a CFA to bolster his resume. He learned of a position with David Rocker (MBA'69) who was starting a $20 million hedge fund called Rocker Partners that specialized in short selling. Rocker's investment philosophy was summarized in the fund's motto, "frauds, fads, and failures."[13] Their mission was to uncover the frauds, see through the hype of fads,

and to find the companies that might be failures. Stirred by his loss in Data Access Systems, it was an exciting opportunity for Cohodes. Cohodes joined Rocker in 1985 and together they grew Rocker Partners to over $2 billion by (provide time frame).

Cohodes earned recognition for uncovering fraud at Lernout & Hauspie, a Belgian company that made voice-recognition software. Cohodes first came across Lernout when looking for new technology that could help his son Max, who was born with cerebral palsy. Cohodes tested the product and found that it did not perform as he had hoped. After going to trade shows and reading industry publications he began to suspect that the company's public demonstrations of the product were rigged.[14]

With doubts raised, Cohodes turned to Lernout's financials and other available information. He learned that the CEO had run another software company that had gone bankrupt.[15] Cohodes also noted that Lernout had made a series of acquisitions. He worried that acquisitive companies have a great amount of flexibility in reported income as accounting rules allowed companies to make estimates of fair values of assets acquired in an acquisition and for reserves to be booked as liabilities that can later be reversed into income. Cohodes also noted that a large percentage of Lernout's sales came from related parties which made him suspect that Lernout was buying product from itself to artificially inflate sales. In early 2000 Lernout purchased two U.S.-based companies which required it to comply with U.S. financial reporting standards which were more stringent than the Belgian-based standards they had used to date. In their subsequent reporting of financial results for the first half of 2000, Cohodes noticed that Lernout's Korean sales went from less than $100,000 in the first quarter of 1999 to $59.9 million one year later.[16]

Cohodes contacted the SEC with his suspicions but felt that getting the SEC to investigate and prosecute the company would be slow going. Cohodes went to the media contacting Herb Greenberg, a *MarketWatch* reporter well known for reporting on accounting issues at public companies, and Jesse Eisinger of the Wall Street Journal and shared his suspicions.

After pursuing his own investigation, on August 8, 2000 Eisinger published his findings, reporting that "some companies that L&H has identified as Korean customers say they do no business at all with L&H. Others say their purchases have been smaller than L&H says."[17] Shares of Lernout and Hauspie were trading at $35 at the time of the revelations. By late November 2000, L&H had filed for bankruptcy leaving shares in the company trading at $0.62 at year end. In 2001, Mssrs. Lernout and Hauspie and two other officers of the company were arrested for fraud.[18]

Cohodes soon developed a reputation for spotting fraud and was described in the *New York Times* as someone, "who knew every trick company executives used to make their operations look better than they actually were. He prides himself on being able to spot trouble."[19] Richard Sauer, former SEC attorney and author of *Selling America Short*, has called Cohodes "the hardest-working man in the hedge-fund industry."[20]

Cohodes, reflecting on himself said,

"I'm an understated guy; I don't dress well. I walk around in crocs and shorts and t-shirts. I'm not a country club type; I'm not a private plane type. I'm none of that stuff. But I have tremendous belief in my ability to figure things out, and I don't give up when I think I'm right."[21]

Not all of Rocker Partners positions were as successful as Lernout and Hauspie. Cohodes once bet against the frozen yogurt chain, TCBY, shorting their shares on his belief that their product was just a fad. Consumers loved the product, however, and the company planned a large-scale expansion. The

stock quickly rose 5-fold and Cohodes covered his short position. From this experience he learned that:

> "It's hard to make money on a short when you are only investing on an opinion – you have to pay attention to facts and evidence and stay away from 'manias,' as things can go a lot further than you want to believe. I focus on companies that have no reason to be in business, no real competitive advantage, or that have no business [despite what they report]."[22]

Cohodes decided he would never short a good company or good management. He said he preferred "to bet against the bad guys" and as he saw with the CEO of Data Access Systems, the "bad guys are often repeat offenders."[23]

Cohodes Spots Warning Signs at NovaStar

In the late 1990's Cohodes brother-in-law worked briefly at NovaStar during its start-up phase. Cohodes recounted, "He used to tell me what a crap operation this was, that they would loan money to animals and that the people were worse than bad."[24] At the time, NovaStar's stock traded in the $2-3 range. Remembering this exchange, Cohodes watched as NovaStar almost went under during the Russian financial crisis of 1998, and then reversed and began a growth trajectory in 2000.

In the first half of that year, NovaStar underwrote $34 million in mortgages. In the first half of 2001, origination volumes topped $394 million and NovaStar began paying dividends (see **Exhibit 6** for historical origination volumes). Investors took notice of the growth, and by 2003 the stock traded as high as $30. Suspicious of their apparent success, Cohodes probed into the financials and spotted what he believed were a series of red flags (see Exhibit **7a-c** for NovaStar's historical financial statements).

Potential for Manipulation through Gain on Sale Accounting

NovaStar's use of gain on sale accounting was one of the first issues that Cohodes looked at. Each quarter in their SEC filings, NovaStar detailed the assumptions they used in each of their securitizations. Cohodes kept a spreadsheet that tracked the assumptions that NovaStar used for each of its securitization pools and tracked them over time (see **Exhibit 8**). Through analyzing the trends, Cohodes came to believe that NovaStar manipulated its earnings and its balance sheet through the assumptions they used. In mortgage sales, fair value estimates were greatly influenced by managements' estimates of the discount rate, prepayment speed, and credit loss assumptions. By decreasing assumptions, fair value of the retained residuals on the balance sheet and the gain on sale could be increased and vice versa. To be valid, changes to assumptions should be driven by experience with assets in the portfolio and the interest rate environment.

Cohodes spotted several problems with the assumptions that NovaStar used. For instance, in the second quarter of 2005, NovaStar had to raise its prepayment speeds across the board based on declines in interest rates as interest rate declines typically lead to refinancing. At the same time, however, NovaStar decreased the discount rate on some pools and decreased its loss assumptions on most of the pools. The net effect of these changes cancelled each other out, allowing NovaStar to avoid taking an impairment charge. Then, just one quarter later, NovaStar decreased prepayment speeds even though rates had not changed since the prior quarter. In the third quarter of 2005, NovaStar took an impairment charge on mortgage securities booked just one quarter earlier (see **Exhibit 9**), indicating that the assumptions they used didn't hold up for even 90 days. Cohodes saw

this as an indication that the amount of the gain that they booked when they made the sale shouldn't have been booked at all.

Where is the Cash Coming from to pay the Dividend?

Mortgage lenders originate and then securitize pools of mortgages to provide cash to make additional loans. The securitization process provides cash flow to run and grow their business. With origination volumes climbing and reported net income rising, NovaStar continued to raise capital in the public markets through stock offerings. In 2003 NovaStar raised $94 million, followed by another $194 million in 2004, $142 million in 2005, and $143 million in 2006. Cohodes wondered why they needed to raise this kind of capital if business was going as well as they reported.

Cohodes looked at the amount that NovaStar had raised compared to the amount they had paid out in dividends. He noticed that the amount of capital they had raised very closely approximated the amount they had paid in dividends. Cohodes probed further by examining the cash flow of the company. Looking at the reported cash flow Cohodes came to believe that NovaStar did not have enough cash to pay their dividend. Cohodes calculated the net unencumbered cash flow of the company—the free cash flow. To do this he started with GAAP cash from operations and subtracted from this changes in the loans held-for-sale that was included in cash from operations. Then he added cash flow generated by residual assets and subtracted cash required to be paid on securitizations (see **Exhibit 10 for a dividend analysis**). In sum, he took into account cash generated from the business and the investment portfolio and subtracted out the cash required to be paid on the loans held for sale and as payment on interest margin securitizations. Cohodes found that there was never enough free cash to pay the dividend.

Were Underwriting Practices Fraudulent?

Remembering the comments his brother in law had made to him, Cohodes was distrustful of the underwriting practices at NovaStar. Cohodes also remembered an April 2002 article in *American Banker*, in which the CEO had talked about the technology that NovaStar used, noting that "in thirty seconds brokers can complete an application and get multiple approvals back, saving them hours. In a call center environment, it's nice to approve them right on the phone."[25] While the technology clearly enabled quantity, Cohodes wondered what it meant about quality. Digging further, Cohodes came across some promotional memos sent by NovaStar to mortgage brokers with messages such as "Did You Know NovaStar Offers to Completely Ignore Consumer Credit!" and "Ignore the Rules and Qualify More borrowers with Our Credit Score Over-ride Program."[26]

In 2003, while talking to mortgage insurer PMI, Cohodes learned that they had stopped providing mortgage insurance to NovaStar after they discovered that borrowers' incomes had been misrepresented in loan documents.[27] Cohodes noted that there were two main implications of this development. First, it was a negative assessment of the underwriting quality at NovaStar. Second, a lack of mortgage insurance should cause NovaStar to a lower the valuation of the residual assets held on its books as the loss assumptions should increase significantly as losses would not be able to be offset with insurance. He also noticed that NovaStar did not mention the change to shareholders in any public filings despite SEC requirements to notify investors of meaningful changes to their business.

Were the Branches Legitimate?

Cohodes became suspicious of NovaStar's branch system after examining their financial statements. He noticed that in 2003, NovaStar expanded from 246 branches in Q1 to 432 in Q4, a 75%

increase. Over the same time frame, general and administrative expenses (G&A) only increased 19%. Cohodes wondered where the expenses were to pay for these brick and mortar locations. To investigate further, Cohodes took a road trip to see NovaStar's offices for himself. He chose to head to Nevada, which was a key growth market for the company. Cohodes reported that he "found one branch in a massage parlor, another in a guy's house--it was a complete charade."[28]

Cohodes was not the only one who realized that there were issues with NovaStar's Nevada branches. In February of 2004, Nevada state authorities ordered NovaStar to cease operations in the state after they discovered that NovaStar's Nevada branches had never obtained the appropriate licenses to do business in the state.[29] Cohodes saw this and also noted that NovaStar did not disclose this information to investors in subsequent filings.

Dividend Equivalent Rights (DERs) – Management Enriches Themselves

While looking through NovaStar's filings, Cohodes found mention in the discussion of stock-based compensation that the options issued by the Company to senior management came "with attached dividend equivalent rights."[30] Essentially, these rights entitled management to receive dividends on the options that executives received as part of their compensation. Thus, they didn't actually have to exercise the options and buy the stock to receive the dividend. Cohodes said he took this as evidence of "how despicable they were, since they were taking the dividends that the stock paid out without taking on the risk of owning the shares."[31] However, DERs were not uncommon, companies often paid them out to avoid diluting employees who were holding options to prevent dilution of the value of the options.

Analysts, the Press, and the SEC enter the Debate

When Cohodes began his short position in NovaStar, he had hoped to lay low. He recalled basing his bet, "80% on NovaStar and 20% on a macroeconomic overview of the housing market unwinding," because, as he saw it, "Novastar had all the classic signs of a short – a management team that had failed before, aggressive accounting, weak cash flow, no competitive advantage and a weak position in a bad business."[32]

After starting the short position at a price of around $45, however, Cohodes watched as the "housing market went on an absolute tear, and NovaStar along with it."[33] When the stock neared $100, Cohodes realized that he had two plays in the short—the company-specific play and an anti-housing bet. When the stock neared $200, he saw a third play come into the picture—fraud. At $250, Cohodes recalled, "I had my faith singed and my hair was about ready to fall out, but ultimately I kept with it because there was a company bet, a macro bet, a fraud bet, and a bet that the financial system was in trouble."[34] He kept shorting the shares all of the way up, increasing his bet against the stock.

In early 2003 Cohodes began communicating with the SEC. On a regular and frequent basis he sent them summaries of all of the issues that he saw with NovaStar. After the company hosted its quarterly earnings calls, Cohodes would annotate the transcripts with comments on what management was saying and would send them to the SEC. He sent them copies of flyers that NovaStar sent out within their system proclaiming "No docs [documents] No problems!" Cohodes recalled that, "each flier was crazier than the next."[35] He also spent what seemed to him like countless hours on the phone with the SEC explaining the issues with gain on sale accounting and how the estimates that management used could manipulate earnings.

Watching the stock go ever higher, Cohodes also reached out to the press, sending them his background research on the company. On May 26, 2003, with the stock trading above $100, Forbes published an article entitled "Supernovas Don't Last: NovaStar."[36] The article criticized NovaStar's use of gain-on-sale accounting, noting that, "like other mortgage originators this one uses an accounting method that permits it to count unhatched chickens. Instead of recognizing profits from the securitizations over the life of the home loans, NovaStar books all the anticipated profits up front."[37] The article also reported that NovaStar's "gain-on-sale earnings—net of losses on related derivative transactions—accounted for a huge 84% of its first-quarter income; that's up from 2002's fourth-quarter 60%"[38]

Investors seemed to ignore the criticism, however, as the stock continued its upward march, reaching $130 roughly a month after the article was published. NovaStar had an active and loyal following in the financial community. Investors, sell-side analysts, and an active community of bloggers supported the stock. Investors and analysts continued to be attracted to the growth that NovaStar was reporting—growth in loan origination, branches, its mortgage investment portfolio, and earnings. They also liked the large dividend that NovaStar—because it was structured as a REIT—paid out, providing a steady source of income to investors.

Stephen Laws, an analyst at Hambrecht and Quist, initiated coverage on NovaStar on August 8, 2003, with a buy recommendation, saying:

> "We believe the company's recent strong branch growth will help drive mortgage origination growth in 2004 and believe that shares are attractive at current levels. While overall origination volume typically declines during times of rising interest rates, NovaStar focuses on non-conforming mortgages, which are less sensitive than agency mortgages to interest rates…NovaStar believes its target market of mortgages totals roughly $200 billion, of which we believe the company has a market share of roughly 2.5-3.0%."[39]

The internet also provided an active forum to those who wanted to support NovaStar. NFI-info.net was a website set up by supporters of NovaStar. The website prominently displayed NovaStar's dividend history and provided background information on the company's ability to deliver consistent returns along with a generous dividend.[40]

A shift in the media's depiction of NovaStar began taking place in early 2004, when Nevada state officials told NovaStar to close down their Nevada branches. On April 12th, the *Wall Street Journal* reported that,

> "…none of the Kansas City, Mo., mortgage lender's Nevada branches were licensed to do business in the state. In an interview, Nevada's top mortgage-lending regulator said he also found that most of the 15 branches that NovaStar claimed to have in the state didn't actually exist. . . The company didn't disclose the matter to investors in its regulatory filings."[41]

The stock had an immediate reaction, falling 30% that day. Analysts rushed to the company's defense. Stephen Laws came out the following day vigorously defending the shares: "Monday's sell-off of roughly 30% was a result of an article in the Wall Street Journal, which presented a one-sided and inaccurate view on the Company, in our opinion."[42] Laws then reiterated his Buy rating, explaining that, "…rising interest rates should have little impact on NovaStar's business."[43]

Things appeared to be getting worse for NovaStar when, on April 19, 2004, NovaStar announced that the SEC had launched an informal inquiry into its business practices.[44] The investigation never

seemed to gain much traction,[45] and with continued support from analysts and an active internet following, the stock slowly began to recover.

By June 11, 2004 shares had climbed off of their low of just under $130 back to roughly $150 when Herb Greenberg of *MarketWatch* published the following critique:

> "Boring is definitely not how you would describe NovaStar, which sticks out like a sore thumb on the investment-metrics scale. Nothing underscores the difference than NovaStar's dividend, which is a jaw-dropping 41 percent of its book value compared to the mid-teens for most other mortgage REITs."[46]

The market seemed to ignore the continued warnings. In November of 2004 NovaStar completed an offering of 1.5 million shares in a secondary issuance priced at $170 per share. By early December 2004, shares were trading back above $200. NFI-Info.net denounced short sellers and journalists as "attempting to deprive the small investor of the boon that was NovaStar"[47] and went so far as to post Cohodes' home address along with information about his family and a picture of his son, Max.[48]

Despite ups and downs in stock prices, 2004 was a record year for NovaStar. Origination volumes climbed to $8.4 billion and NovaStar's mortgage portfolio climbed to $12.2 billion. The press had actively questioned NovaStar's accounting and had revealed several problems at NovaStar including the Nevada licensing issue. The SEC had announced an inquiry. Yet investors seemed to ignore the red flags and the share price continued to increase. The stock traded as high as $227 in mid-December, up from a low of $127 after the issue concerning Nevada licensing surfaced in April.

The macro economy was starting to change. On December 22, 2004, NovaStar reduced their earnings guidance to $4.10-$4.10 per share due to rising interest rates. The consensus estimate at the time was $4.67. The shares quickly fell to the mid-$100 range. In March, however, NovaStar was able to complete an offering of $48 million in subordinated floating rate debentures and then raised $64 million in an equity offering at $127.50. Investors were still willing to believe.

Conclusion

NovaStar shares traded in the $110-$150 range until late 2006. By then, problems in the macro economy had become more apparent and had begun to weigh on the shares. NovaStar's 2006 quarterly income statements revealed that in the second half of 2006, 90% of NovaStar's pre-tax income came from gain on sale accounting.[49] On January 8, 2007, JMP Securities downgraded the stock at $93 based on weakening housing market trends. The stock began a downward trend which accelerated when, on February 20, 2007, NovaStar announced:

> "The credit performance of our portfolio, and specifically our 2006 originations, deteriorated during the fourth quarter, resulting in impairments on mortgage securities and additional loss provisions for loans held-in-portfolio in the REIT. Also, our gains upon securitization were reduced during the quarter because of lower whole loan prices. Furthermore, during the fourth quarter, we experienced a greater level of loan repurchase requests due to early payment defaults than we have historically. . . As a result, during the period 2007 through 2011, we expect to recognize little, if any, taxable income. Given this outlook, management is currently evaluating whether it is in shareholders' best interest to retain the company's REIT status."[50]

Without taxable income, NovaStar would be unable to pay the dividends that had for so long attracted investors. Within several months the shares were trading in the single digits. On April 16,

2007, NovaStar announced that they had hired Deutche Bank and were considering a sale of the company. On September 4, 2007, Deloitte and Touche informed the company that it would not sign off on their financial statements without the inclusion of a "going concern" clause.[51]

It took four years for the stock to cross below the level that Cohodes had originally shorted it at. After paying out the dividends on the shares that he had borrowed to be short over that time frame, Cohodes was left with profits that he said amounted to "a Butterfinger, a Big Mac, and maybe a $50 bill."[52]

Despite this, Cohodes took pride in the fact that he withstood so much for so long. With the NovaStar stock finally cracked, it was on to the next short. When asked what he thought to be the most important characteristic of a short-seller, Cohodes responded:

> "Short selling is a difficult and not always lucrative business – you spend 96% of your time in a vicious negative feedback loop where everyone thinks that you are the bad guy. You have to be a highly self-confident type of person who is able to stand alone, because you have no natural advocates. …It's battle, battle, battle, victory, then move on."[53]

Exhibit 1 Short Selling

Short sellers bet on declines in security prices. Short sellers borrowed securities from a lender, and sold the securities with the intention of buying back that identical security to return to the lender at a later time. Short selling was almost always done with liquid securities – stocks, commodities, currencies – that can be repurchased in public markets at any time. A short seller closed or "covered" his position when he purchased the security on the open market and returned it to the lender. If the price declined, the short seller made a profit. If the price rose, the short seller realized a loss.

A short seller typically contacted a broker to initiate a short position. The broker then confirmed if it was able to locate an owner of the underlying securing that was willing to lend it. If a lender could be found, the broker sold the security as instructed by the short seller and credited the short seller's account. The broker was required to deliver the security to the short seller within three days of initiating the position. A naked short sale occurred when the underlying security was not delivered to the short seller within three days. Custodian banks that hold assets for large institutional investors have been the largest lenders, although a number of specialty third-party lenders also entered the equity lending market.

Short selling had several requirements and limitations. If a stock paid a dividend during the time the short seller's position was open, the short seller was required to pay that dividend to the lender who was the beneficial owner. Additionally the short seller was not entitled to the voting rights on borrowed securities. Voting and dividend rights both rested with the beneficial owner.

A short seller was also subject to margin calls. Typically, a broker required a margin of collateral to be maintained against a short position. The collateral protected the broker as theoretically, there is no limit to a loss that a short seller can incur if the price of the security continued to rise. If the short position became significantly negative, the broker could initiate a margin call requiring the short seller to add more collateral to the account or to cover the short position.

A "short squeeze" - a rapid increase in a stock price - could be caused by a when numerous investors simultaneously attempted to cover short positions, artificially inflating demand. This rise in price triggers margin calls for others who have sold the security short, further amplifying the effect of the short squeeze. Even if a stock was overpriced, it could become even more overpriced in these circumstances, and the short seller would be required to buy the securities back in order to cover their position.

Data on short sales has become widely available. Notable pieces of available information are short interest, the percentage of the share base that is out short and days to cover, the number of days of average trading volume it would take to cover short positions.

Source: Compiled by case writers.

Exhibit 2 Sub-Prime Mortgage Industry

Prior to 1980, borrowers with inadequate credit history were unable to obtain a mortgage. The Depository Institutions Deregulatory and Monetary Control Act of that year eliminated controls on mortgage rates, thereby permitting lenders to charge higher rates to borrowers with poor quality credit.[54] The ability to offer higher rates to offset the higher risk associated with this type of borrower gave lenders the ability to earn returns sufficient to warrant entering into the transaction.

In 1989, legislative changes were made to the Community Reinvestment Act (CRA) that was originally signed into law in 1977. The CRA was designed reduce a practice known as "redlining" -- demarking areas on a map, typically low and moderate income neighborhoods, that businesses would avoid. The 1989 update to the CRA required that a written examination conducted by federal regulators, that detailed lenders' activity in redlined areas, be made publicly available. This made lenders publicly accountable to service low and moderate income areas as researchers, analysts, and advocacy groups were able to examine the results.

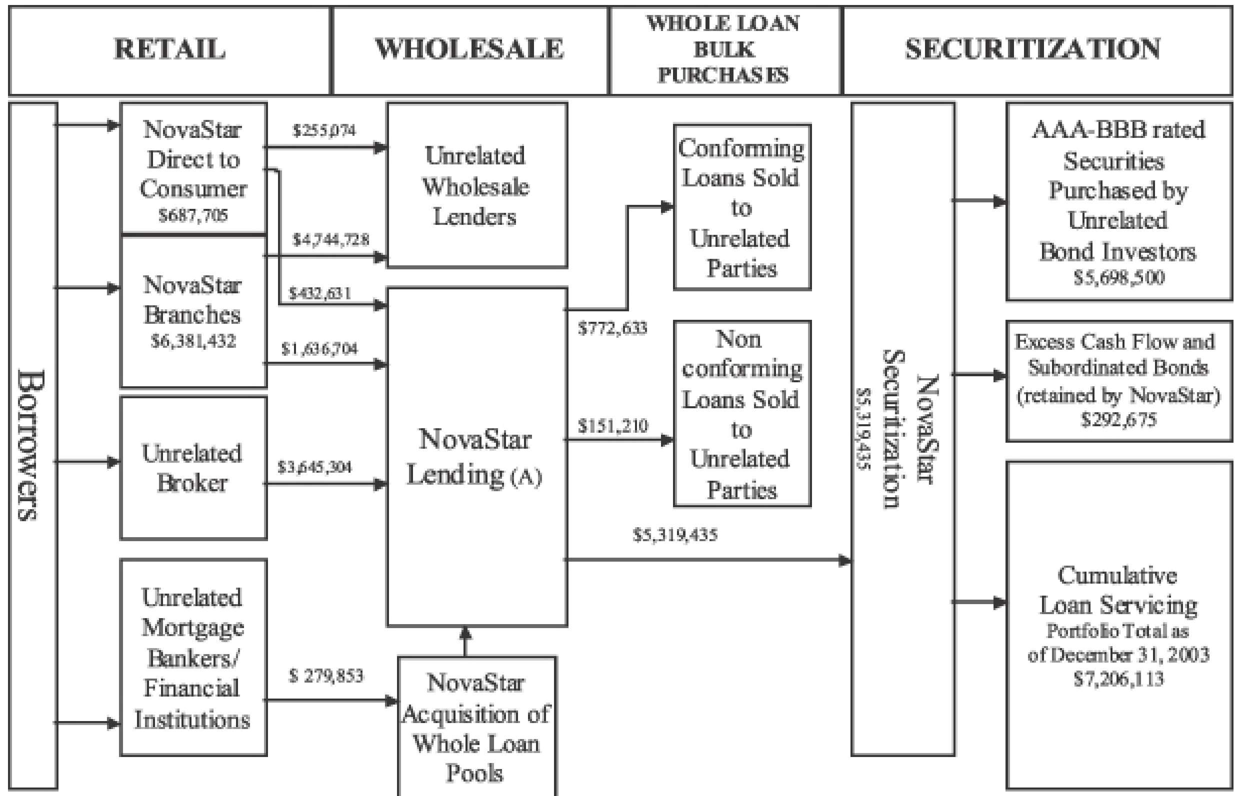
In 1992, the Federal Housing Enterprises Financial Safety Act went one step further and required Fannie Mae and Freddie Mac, the two government sponsored enterprises that securitized mortgages, to devote a percentage of their lending to support affordable housing.[55] Securitization of affordable housing loans expanded as did the secondary market for those loans.[56] Thus, the subprime lending industry began a rapid phase of growth that would contribute to a rise in home ownership rates in the United States from 64% in 1994, where rates had plateaued for many years, to 69.2% in 2004.[57] The industry stalled in late 1998 when the Russian financial crises tightened credit markets, but that was only temporary. In 2000, the industry began a rapid growth phase driven by the ability to access the credit market through the pooling and reselling of loans to investors, changes to tax legislation that made mortgage interest the only consumer loan on which interest payments were tax deductible, government policy aimed at broadening home ownership in the U.S., low interest rates, and rising housing prices.

Numerous parties were involved in the subprime lending business including borrowers, mortgage brokers, lenders (banks, credit unions, mortgage companies), investment banks, rating agencies and investors.[58] Subprime lenders typically operated three lines of business – loan origination, sale or securitization, and loan servicing.[59] Origination involved attracting borrowers, processing loan applications, and funding the mortgages. To fund operations, originators pooled and either sold or securitized mortgages as mortgage backed securities (MBSs). Loan servicing involved collecting payments and paying loan holders, as well as paying real estate taxes and insurance on the underlying properties.

Subprime borrowers, also referred to as "nonconforming borrowers," did not satisfy the credit, collateral, documentation or other underwriting standards required by conventional mortgage lenders and loan buyers. The loans therefore involved higher credit risk and thus carried coupons that were typically 200-300 basis points higher than conforming loans. Typically, subprime loans had higher loan to value ratios as borrowers often did not have capital to put down sizeable down payments.

Source: Compiled by case writers.

Exhibit 3 NovaStar's 2004 Production



Source: NovaStar 2004 10-K accessed via www.sec.gov October 2011.

Exhibit 4 Securitization and the use of Gain on Sale Accounting

Securitization is the process of selling the rights to future cash flow streams from receivables or financial assets to outside investors. Assets are typically pooled to diversify the risk to outside investors. The practice is most common in financial services but is also used in retail. Securitization provides an immediate source of cash for assets that would otherwise pay out a cash flow stream over time.

Securitization can be accounted for using either secured borrowing accounting or sale accounting. In a secured borrowing transaction the amount sold is reflected on the balance sheet as secured borrowing and receivables remain on the balance sheet. Under sale accounting, the receivable are debited from the balance sheet while cash and any retained interests are credited on the balance sheet. A gain or loss on the sale is recognized from the securitization. The amount of the gain/loss is calculated as the difference between the sales price and the estimated fair value of the asset. Thus, in essence, securitization enables immediate recognition of the net present value of the cash flows expected over the life of the asset sold.

SFAS 140, the Financial Accounting Standards Board's Statement on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, was the governing accounting principal on gain on sale accounting. In a gain on sale transaction, the gain was calculated as the difference between the cash proceeds received in the sale and the estimated fair value of the mortgage components that were sold. SFAS required that, in the absence of a market price, the fair value be estimated. The fair value was derived by discounting the projected future cash flows using management's assumptions for default rate, prepayment speed, and discount rates. Thus, deriving fair value required estimates of uncertain future events. NovaStar management noted annually in their 10-K:

> The estimated fair value of the securitization components is considered a "critical accounting estimate" as 1) these gains or losses represent a significant portion of our operating results and 2) the valuation assumptions used regarding economic conditions and the make-up of the collateral, including interest rates, principal payments, prepayments and loan defaults are highly uncertain and require a large degree of judgment.[60]

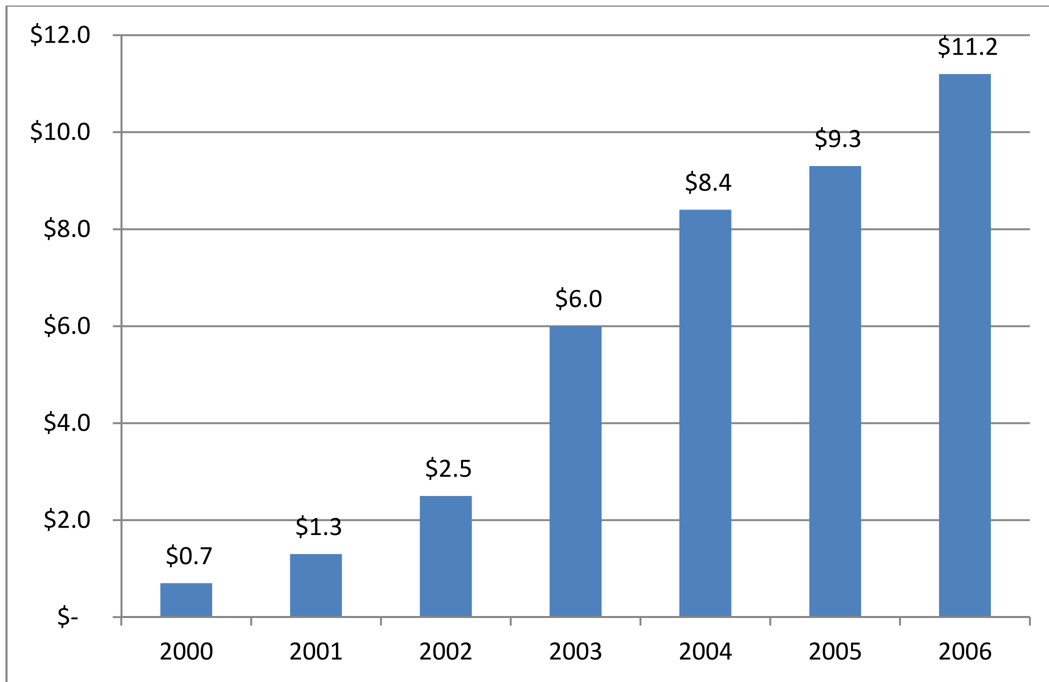
SFAS 140 was put into place in 1997, updating its predecessor SFAS 125 by also requiring the disclosure of estimates used to calculate fair value.

SFAS 140 further required that the fair value estimate be broken down into the components that were sold and the components that were retained so that the original carrying value could be pro-rated between the components sold and retained. Thus, the fair value estimate of the retained interests impacted the amount of gain recognized in securitization.

In a securitization components of the mortgages that were sold were removed from the consolidated financial statements while the fair value estimate of the retained interests was carried on the balance sheet. Thus, the estimates used to calculate fair value influenced not only the size of the gain in a gain on sale transaction but also affected the size of assets recorded on the balance sheet.

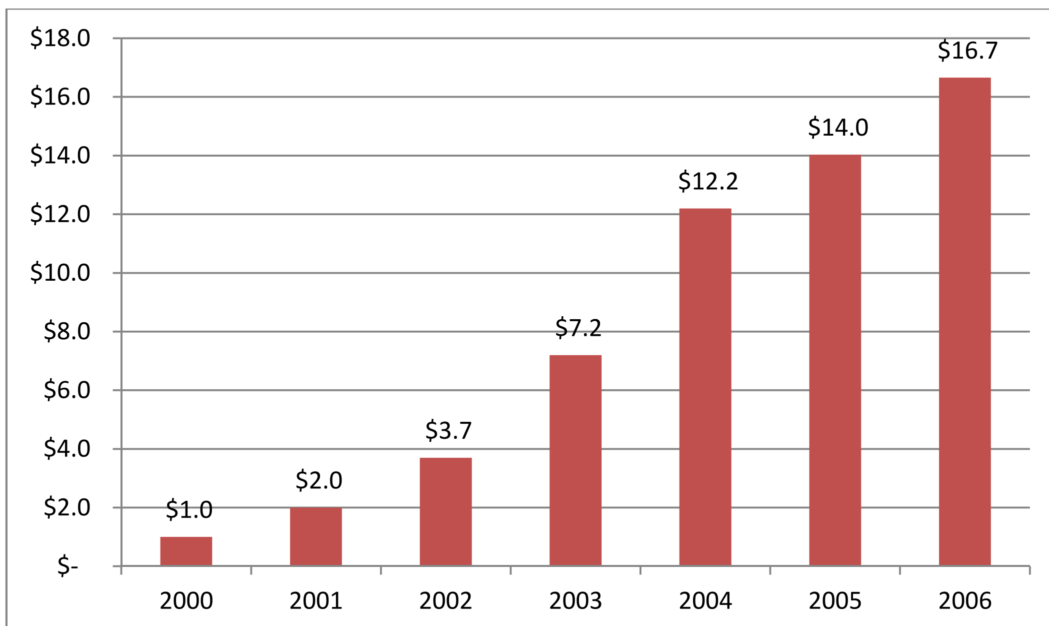
Source: Compiled by case writers.

Exhibit 5 NovaStar's Origination Volumes 2000 – 2006 ($billions)



Source: NovaStar 2000-2006 10-Ks accessed via www.sec.gov October 2011.

Exhibit 6 NovaStar's Loan Servicing Portfolio, Total Principal ($billions)



Source: NovaStar 2000-2006 10-Ks accessed via www.sec.gov October 2011.

Exhibit 7a NovaStar Income Statement 2001-2006

Fiscal Year Ended December 31	2001	2002	2003	2004	2005	2006
Interest Income	57.9	107.1	170.4	224.0	299.8	494.9
Interest expense	27.4	27.7	40.4	52.5	80.8	235.3
						-
Net interest income before provision for credit losses	30.5	79.4	130.1	171.6	218.9	259.6
Provision for credit losses	(3.6)	0.4	0.4	(0.7)	(1.0)	(30.1)
Net interest income	26.9	79.8	130.4	170.8	217.9	229.4
Gains on sales of mortgage assets	37.3	53.3	144.0	145.0	68.2	41.7
Gains (losses) on derivative instruments	(4.0)	(36.8)	(30.8)	(8.9)	18.2	12.0
Impairment on mortgage securities - available for sale	-		-	(15.9)	(17.6)	(30.7)
Fee income	21.0	36.0	68.3	102.8	46.3	29.0
Premiums for mortgage loan insurance	(2.7)	(2.3)	(3.1)	(4.2)	(5.7)	(12.4)
Other income (expense), net	1.9	1.4	0.4	6.6	20.9	0.6
Total other operating income	53.6	51.5	178.8	225.3	130.2	40.3
Compensation and benefits	26.9	49.1	90.0	138.5	116.7	124.2
Office administration	6.4	10.1	22.9	38.6	32.1	27.5
Professional and outside services	2.0	3.4	7.5	37.8	19.6	21.0
Loan Expense	1.9	8.0	26.2	19.9	13.9	7.4
Marketing	7.0	11.4	23.3	18.8	10.9	4.9
Other	2.3	2.6	4.5	17.5	22.2	16.3
Total general and administrative expenses	46.5	84.6	174.4	271.1	215.4	201.3
Income from continuing operations before income taxes	34.0	46.7	134.9	125.0	132.7	68.5
Income tax (benefit) expense	-	(2.0)	22.9	5.4	(10.9)	(8.7)
Income from continuing operations	34.0	48.8	112.0	119.6	143.6	77.2
Loss from discontinued operations, net of income tax	-	-	-	(4.1)	(4.5)	(4.3)
Cumulative effect of a change in accounting principle						
Net income	34.0	48.8	112.0	115.5	139.1	72.9
Dividends on preferred shares	(5.0)	-	-	(6.3)	(6.7)	(6.7)
Net income available to common shareholders	29.0	48.8	112.0	109.1	132.5	66.3
EPS from continuing operations	$1.69	$2.35	$5.04	$4.47	$4.62	$2.06
Loss from discontinued operations, net of tax	$0.00	$0.00	$0.00	($0.16)	($0.15)	($0.12)
Net income available to common shareholders	$1.69	$2.35	$5.04	$4.31	$4.46	$1.94
Diluted EPS from continuing operations	$1.59	$2.25	$4.91	$4.40	$4.57	$2.05
Loss from discontinued operations, net of tax	$0.00	$0.00	$0.00	($0.16)	($0.15)	($0.12)
Net income available to common shareholders	$1.59	$2.25	$4.91	$4.24	$4.42	$1.92
Weighted average basic shares outstanding	20.1	20.8	22.2	25.3	29.7	34.2
Weighted average diluted shares outstanding	21.4	21.7	22.8	25.8	30.0	34.5
Dividends declared per common share	$0.48	$2.15	$5.04	$6.75	$5.60	$5.60

Source: NovaStar 2001-2006 10-K's accessed via www.sec.gov December 2011.

Exhibit 7b NovaStar Balance Sheet 2001-2006

Fiscal period end December 31	2001	2002	2003	2004	2005	2006
Cash and cash equivalents	30.8	79.7	118.2	268.6	264.7	150.5
Mortgage loans - held for sale	139.5	983.6	698.0	747.6	1,291.6	1,741.8
Mortgage loans - held in portfolio, net	226.0	149.9	94.7	59.5	28.8	2,116.5
Mortgage securities - available for sale	71.6	178.9	382.3	489.2	505.6	349.3
Mortgage securities - trading				143.2	43.7	329.4
Mortgage servicing rights	6.4	7.9	19.7	42.0	57.1	62.8
Corporate advances to borrowers		11.9				
Deferred income tax asset, net					30.8	47.2
Servicing related advances			19.3	20.2	26.9	40.9
Warehouse notes receivable					25.4	39.5
Accrued interest receivable	5.5	7.7	3.7		-	37.7
Real estate owned					-	21.5
Derivative instruments, net				18.8	12.8	16.8
Property and equipment, net				15.5	13.1	
Assets acquired through foreclosure	13.2	5.9	3.2			
Other assets	19.3	27.0	60.9	56.8	35.2	74.3
Total Assets	**512.4**	**1,452.5**	**1,400.0**	**1,861.3**	**2,335.7**	**5,028.3**
Short term borrowings	143.4	1,025.5				
Short term borrowings secured by mortgage loans			639.9	720.8	1,238.1	1,631.8
Short-term borrowings secured by mortgage securities			232.7	184.7	180.4	503.7
Other short term borrowings					-	16.8
Asset-backed bonds	219.0	199.7				
Asset-backed bonds secured by mortgage loans			89.4	53.5	26.9	2,067.5
Asset-backed bonds secured by mortgage securities			43.6	336.4	125.6	9.5
Junior subordinated debentures					48.7	83.0
Due to securitization trusts				20.9	44.4	107.0
Dividends payable	4.8	16.8	30.6	73.4	45.1	1.7
Accounts payable and other liabilities	15.2	27.2	63.7	45.2	62.3	92.7
Total Liabilities	382.4	1,269.2	1,099.7	1,435.0	1,771.5	4,513.7
Redeemable preferred stock				0.0	0.0	0.0
Common stock	0.1	0.1	0.2	0.3	0.3	0.4
Additional paid-in-capital	137.9	133.4	231.3	433.1	581.6	741.7
Accumulated deficit	(15.9)	(12.0)	(15.5)	(85.4)	(128.6)	(263.6)
Accumulated other comprehensive income	9.2	62.9	85.2	79.1	111.5	36.5
Notes receivable from founders	(1.3)	(1.1)				
Other	-	-	(1.0)	(0.8)	(0.7)	(0.6)
Total Shareholders' Equity	130.0	183.3	300.2	426.3	564.2	514.6
Total Liabilities and Equity	**512.4**	**1,452.5**	**1,400.0**	**1,861.3**	**2,335.7**	**5,028.3**

Source: NovaStar 2001-2006 10-Ks accessed via www.sec.gov December 2011.

Exhibit 7c NovaStar Cash Flow Statement 2001-2006

Fiscal year ended December 31	2001	2002	2003	2004	2005	2006
Net Income	**32.3**	**48.8**	**112.0**	**115.4**	**139.1**	**72.9**
Loss from discontinued operations	-	-	-	23.6	11.7	4.3
Income from continuing operations	**32.3**	**48.8**	**112.0**	**138.9**	**150.8**	**77.2**
Amortization of mortgage servicing rights	2.1	4.6	9.0	16.9	28.4	33.6
Retention of mortgage servicing rights				(39.3)	(43.5)	(39.5)
Impairment on mortgage securities available-for-sale				15.9	17.6	30.7
(Gains) losses on derivative instruments	4.0	36.8	30.8	8.9	(18.2)	(12.0)
Depreciation expense	0.9	1.2	3.9	6.1	7.4	7.3
Amortization of deferred debt issuance costs	1.0	0.2	1.1	5.0	5.7	3.4
Compensation recognized under stock compensation plans		3.2	1.3	1.8	2.2	2.5
Provision for credit losses	3.6	(0.4)	(0.4)	0.7	1.0	30.1
Cumulative effect of change in accounting principle	1.7					
Amortization of premiums on mortgage loans	3.2	1.9	1.1	0.7	0.4	10.4
Interest capitalized on loans held-in-portfolio					-	(29.5)
Forgiveness of founders promissory notes	0.1	0.1	0.1	0.1	0.1	0.1
Provision for deferred income taxes	-	(4.7)	(5.8)	(1.3)	(12.7)	(8.6)
Accretion of available-for-sale and trading securities	(11.7)	(56.5)	(98.8)	(100.7)	(172.0)	(159.0)
Gains on sales of mortgage assets	(37.3)	(53.3)	(144.0)	(105.7)	(21.6)	(2.3)
Losses (gains) on trading securities					(0.5)	3.2
Originations and purchases of mortgage loans held-for-sale	(1,401.6)	(2,800.4)	(6,047.5)	(8,539.9)	(9,379.7)	(11,275.9)
Proceeds from repayments of mortgage loans held-for-sale				28.0	9.9	77.5
Repurchase of mortgage loans from securitization trusts					(6.8)	(183.8)
Proceeds from sale of mortgage loans held-for-sale to third parties	110.9	391.5	966.5	64.5	1,176.5	2,260.8
Proceeds from sale of mortgage loans held-for-sale in securitizations	1,192.0	1,532.5	5,207.2	8,173.8	7,428.1	5,923.0
Purchase of mortgage securities - trading				(143.2)	-	(205.1)
Proceeds from paydowns of mortgage securities - trading					-	9.4
Proceeds from sale of mortgage securities - trading					143.2	11.2
Changes in:						
Servicing related advances				(0.7)	(6.8)	(13.9)
Accrued interest receivable				(23.8)	(35.3)	(69.5)
Derivative instruments, net				13.6	2.5	(0.4)
Other assets	(26.5)	(56.1)	(61.6)	(13.7)	(9.8)	(24.4)
Accounts payable and other liabilities	1.3	(3.1)	33.4	(24.7)	19.6	30.2
Net cash used in operating activities from continuing operations	**(123.9)**	**(953.6)**	**8.3**	**(517.9)**	**(713.4)**	**(3,513.1)**
Net cash provided by (used in) operating activities from discontinued operations	-	-	-	(47.8)	(13.7)	2.2
Net cash used in operating activities	**(123.9)**	**(953.6)**	**8.3**	**(565.7)**	**(727.1)**	**(3,510.9)**

Exhibit 7c (continued) NovaStar Cash Flow Statement 2001-2006

Fiscal year ended December 31	2001	2002	2003	2004	2005	2006
Proceeds from paydowns on mortgage securities available for sale	40.2	100.1	200.0	346.6	453.8	327.2
Purchase of mortgage securities available-for-sale					-	(1.9)
Proceeds from repayments of mortgage loans held-in-portfolio	125.2	65.5	49.1	31.8	16.7	551.8
Proceeds from sales of available for sale securities	28.6					
Proceeds from sales of assets acquired through foreclosure	20.5	14.9	6.7	4.9	1.9	2.3
Acquisition of retail branches		-			-	(60.1)
Net assets acquired in acquisition of common stock of NFI Holding Corporation	0.9					
Payment on founders' promissory notes	0.6					
Purchases of property and equipment	-	-	-	(7.0)	(5.3)	(10.0)
Net cash provided by investing activities	**216.0**	**180.5**	**255.8**	**376.2**	**467.0**	**809.3**
Proceeds from issuance of asset-backed bonds, net of debt issuance costs	-	66.9	52.3	506.7	128.9	2,505.5
Payments on asset-backed bonds	(139.4)	(86.4)	(120.1)	(254.9)	(363.9)	(565.2)
Payments on asset-backed bonds due to exercise of redemption provisions				-	(7.8)	(18.8)
Proceeds from issuance of capital stock and exercises of equity instruments, net	0.9	1.8	94.3	193.6	142.1	143.5
Net change in short term borrowings	81.5	882.2	(153.0)	53.8	499.7	741.1
Proceeds from the issuance of junior subordinated debentures				-	48.4	33.9
Repurchase of common stock	(0.7)			-	-	(0.0)
Repurchase of warrants		(9.5)				
Dividends paid on vested stock options				-	(2.1)	(2.7)
Dividends paid on preferred stock	(3.2)	(2.0)		(6.3)	(6.7)	(5.0)
Dividends paid on common stock	(2.8)	(30.9)	(99.3)	(132.3)	(195.8)	(237.4)
Net cash provided by financing from continuing operations	**(63.7)**	**822.1**	**(225.7)**	**360.6**	**243.0**	**2,594.9**
Net cash (used in) provided by financing activities from discontinued operations	-	-	-	(20.8)	13.3	(7.4)
Net cash provided by financing activities	**(63.7)**	**822.1**	**(225.7)**	**339.9**	**256.3**	**2,587.4**
Net (decrease) increase in cash and cash equivalents	**28.3**	**48.9**	**38.4**	**150.4**	**(3.8)**	**(114.2)**
Cash and cash equivalents, beginning of year	2.5	30.8	79.7	118.2	268.6	264.7
Cash and cash equivalents, end of year	**30.8**	**79.7**	**118.2**	**268.6**	**264.7**	**150.5**

Source: NovaStar 2001-2006 10-Ks accessed via www.sec.gov December 2011.

Exhibit 8 Impairment on Mortgage Securities; Available-for-Sale by Mortgage Security Q3 2005

Impairment on mortgage securities – available-for-sale. To the extent that the cost basis of mortgage securities - available-for-sale exceeds the fair value and the unrealized loss is considered to be other than temporary, an impairment charge is recognized and the amount recorded in accumulated other comprehensive income or loss is reclassified to earnings as a realized loss. During the nine and three months ended September 30, 2005, we recorded an impairment loss of $10.1 million and $8.3 million, respectively, compared to $8.7 million and $2.6 million during the same periods of 2004. The impairments were primarily a result of the increase in short-term interest rates during 2004 and the first nine months of 2005. The following table summarizes the impairment on our mortgage securities - available-for-sale by mortgage security for the nine and three months ended September 30, 2005 and 2004.

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
Mortgage Securities Available-for-Sale:	**2005**	**2004**	**2005**	**2004**
NMFT Series 1999-1	117	36	-	36
NMFT Series 2004-1	-	6,117	-	-
NMFT Series 2004-2	-	2,539	-	2,539
NMFT Series 2004-4	1,495	-	-	-
NMFT Series 2005-1	1,426	-	1,300	-
NMFT Series 2005-2	7,028	-	7,028	-
Impairment on mortgage securities available-for-sale	10,066	8,692	8,328	2,575

Source: NovaStar Q3 10-Q accessed via www.sec.gov, December 2011.

Exhibit 9 NovaStar Mortgage Securities Valuation Assumptions

Discount Rate

NMFT Series:	At Secur- itization	31-Dec 2002	31-Mar 2003	30-Jun 2003	30-Sep 2003	31-Dec 2003	31-Mar 2004	30-Jun 2004	30-Sep 2004	31-Dec 2004	31-Mar 2005	30-Jun 2005	30-Sep 2005	31-Dec 2005	31-Mar 2006	30-Jun 2006	30-Sep 2006	31-Dec 2006
1999-1	17%	25%	25%	25%	25%	17%	17%	17%	17%	17%	17%	5%						
2000-1	15%	25%	25%	25%	25%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%		
2000-2	15%	25%	25%	25%	25%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%		
2001-1	20%	25%	25%	25%	25%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%		
2001-2	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	20%	20%	20%	20%	20%		
2002-1	20%	25%	25%	25%	25%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	
2002-2	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	20%	20%	20%	20%	20%	20%	
2002-3	20%	25%	25%	25%	25%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%
2003-1	20%		25%	25%	25%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%
2003-2	28%			37%	37%	28%	28%	28%	28%	28%	28%	20%	20%	20%	20%	20%	20%	22%
2003-3	20%				30%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%
2003-4	20%					20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%
2004-1	20%						20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%
2004-2	26%									26%	26%	20%	20%	20%	20%	20%	20%	20%
2004-3	19%									19%	19%	19%	19%	19%	19%	19%	20%	19%
2004-4	25%									26%	26%	20%	20%	20%	20%	20%	20%	20%
2005-1	15%										15%	15%	15%	15%	15%	15%	15%	15%
2005-2	13%											13%	13%	13%	13%	13%	13%	13%
2005-3	15%												15%	15%	15%	15%	15%	15%
2005-4	15%													15%	15%	15%	15%	15%
2006-2	15%															15%	15%	15%
2006-3	15%															15%	15%	15%
2006-4	15%																15%	15%
2006-5	15%																15%	15%
2006-6	15%																	15%

Source: NovaStar 10-Q's 2002-2006 accessed via www.sec.gov, December 2011.

Exhibit 9 (continued) NovaStar Mortgage Securities Valuation Assumptions

Prepayment Assumption

NMFT Series:	At Secur-itization	31-Dec 2002	31-Mar 2003	30-Jun 2003	30-Sep 2003	31-Dec 2003	31-Mar 2004	30-Jun 2004	30-Sep 2004	31-Dec 2004	31-Mar 2005	30-Jun 2005	30-Sep 2005	31-Dec 2005	31-Mar 2006	30-Jun 2006	30-Sep 2006	31-Dec 2006
1999-1	30%	38%	44%	46%	44%	39%	38%	33%	39%	33%	40%	32%						
2000-1	27%	53%	54%	49%	46%	57%	42%	37%	40%	46%	35%	37%	27%	36%	39%	38%		
2000-2	28%	57%	54%	52%	52%	63%	39%	36%	44%	34%	34%	37%	28%	37%	38%	39%		
2001-1	28%	59%	56%	53%	50%	53%	39%	34%	35%	37%	33%	43%	28%	40%	42%	42%		
2001-2	28%	53%	49%	49%	48%	41%	41%	33%	34%	33%	32%	35%	28%	31%	39%	39%		
2002-1	32%	38%	37%	38%	38%	45%	46%	37%	38%	42%	40%	40%	32%	41%	38%	38%	38%	
2002-2	27%	29%	32%	38%	36%	44%	47%	39%	39%	40%	42%	43%	27%	43%	41%	40%	40%	
2002-3	33%	24%	25%	29%	28%	39%	40%	39%	39%	41%	39%	43%	30%	44%	40%	38%	38%	35%
2003-1	28%		22%	24%	24%	28%	36%	33%	38%	39%	38%	41%	28%	39%	37%	33%	34%	32%
2003-2	25%			21%	21%	30%	35%	33%	34%	38%	38%	42%	25%	39%	37%	33%	34%	31%
2003-3	22%				19%	26%	32%	30%	33%	37%	36%	42%	22%	37%	33%	29%	31%	29%
2003-4	30%					33%	37%	36%	42%	44%	44%	49%	30%	46%	43%	39%	41%	38%
2004-1	33%						33%	33%	36%	43%	44%	49%	33%	56%	54%	48%	48%	47%
2004-2	31%							32%	34%	41%	42%	49%	31%	55%	55%	53%	49%	47%
2004-3	34%								34%	39%	42%	48%	34%	53%	55%	54%	53%	48%
2004-4	35%									36%	39%	45%	35%	54%	56%	57%	59%	56%
2005-1	37%										37%	42%	37%	43%	56%	56%	58%	60%
2005-2	39%											39%	39%	51%	53%	51%	53%	54%
2005-3	41%												41%	47%	50%	51%	50%	51%
2005-4	43%													43%	46%	47%	47%	49%
2006-2	44%															44%	45%	46%
2006-3	43%															43%	44%	45%
2006-4	43%																44%	45%
2006-5	43%																43%	44%
2006-6	41%																	42%

Source: NovaStar 10-Q's 2002-2006 accessed via www.sec.gov, December 2011.

Exhibit 9 (continued) NovaStar Mortgage Securities Valuation Assumptions

Expected Credit Losses

NMFT Series:	At Securitization	31-Dec 2002	31-Mar 2003	30-Jun 2003	30-Sep 2003	31-Dec 2003	31-Mar 2004	30-Jun 2004	30-Sep 2004	31-Dec 2004	31-Mar 2005	30-Jun 2005	30-Sep 2005	31-Dec 2005	31-Mar 2006	30-Jun 2006	30-Sep 2006	31-Dec 2006
1999-1	2.5%	5.1%	-	2.9%	4.7%	5.2%	4.6%	4.6%	4.7%	4.8%	4.8%	5.0%						
2000-1	1.0%	2.3%	-	1.6%	1.1%	1.3%	1.1%	1.1%	1.2%	1.2%	1.4%	1.4%	1.4%	1.3%	1.3%	1.4%		
2000-2	1.0%	2.2%	-	2.4%	1.0%	1.0%	0.7%	0.8%	0.7%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%		
2001-1	1.2%	1.8%	-	2.0%	1.1%	1.1%	0.9%	1.1%	1.1%	1.1%	1.2%	1.1%	1.4%	1.3%	1.3%	1.3%		
2001-2	1.2%	1.4%	-	1.6%	1.0%	0.9%	0.7%	0.8%	0.8%	0.8%	0.8%	0.7%	0.7%	0.7%	0.9%	1.0%		
2002-1	1.7%	1.7%	-	1.8%	1.3%	1.3%	0.9%	1.0%	1.0%	0.9%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	
2002-2	1.6%	2.1%	-	1.9%	1.8%	1.8%	1.5%	1.6%	1.6%	1.4%	1.5%	1.4%	1.4%	1.4%	1.4%	1.4%	1.4%	
2002-3	1.0%	1.5%	-	1.1%	1.0%	0.9%	0.9%	0.9%	0.8%	0.7%	0.5%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%
2003-1	3.3%		-	2.5%	2.7%	2.8%	2.2%	2.2%	2.0%	1.8%	1.2%	1.1%	1.3%	1.3%	1.2%	1.2%	1.2%	1.3%
2003-2	2.7%			2.8%	2.9%	2.6%	2.6%	2.2%	1.8%	1.5%	1.0%	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%
2003-3	3.6%				2.9%	3.4%	3.2%	2.9%	2.1%	1.6%	1.0%	0.8%	0.8%	0.7%	0.7%	0.8%	0.7%	0.8%
2003-4	5.1%					5.3%	4.2%	3.9%	2.9%	1.7%	1.4%	1.1%	0.9%	0.8%	0.9%	0.9%	0.9%	1.0%
2004-1	5.9%						5.9%	5.7%	5.0%	3.5%	2.2%	1.7%	1.6%	1.3%	1.1%	1.2%	1.2%	1.3%
2004-2	5.1%							5.1%	4.6%	3.8%	2.7%	1.9%	1.7%	1.4%	1.3%	1.2%	1.2%	1.3%
2004-3	4.5%								4.5%	3.9%	3.3%	2.5%	1.9%	1.5%	1.4%	1.4%	1.3%	1.5%
2004-4	4.0%									3.7%	3.1%	2.6%	2.2%	1.5%	1.4%	1.3%	1.2%	1.3%
2005-1	3.6%										3.6%	3.2%	2.8%	1.8%	1.6%	1.5%	1.6%	1.7%
2005-2	2.1%											2.1%	2.1%	1.5%	1.2%	1.2%	1.3%	1.5%
2005-3	2.0%												2.0%	2.0%	1.4%	1.2%	1.3%	1.5%
2005-4	2.3%													2.3%	2.0%	1.8%	1.9%	2.0%
2006-2	2.4%															2.4%	2.9%	3.2%
2006-3	3.0%															2.7%	3.8%	4.3%
2006-4	2.9%																3.0%	3.5%
2006-5	3.9%																4.1%	4.8%
2006-6	3.7%																	3.9%

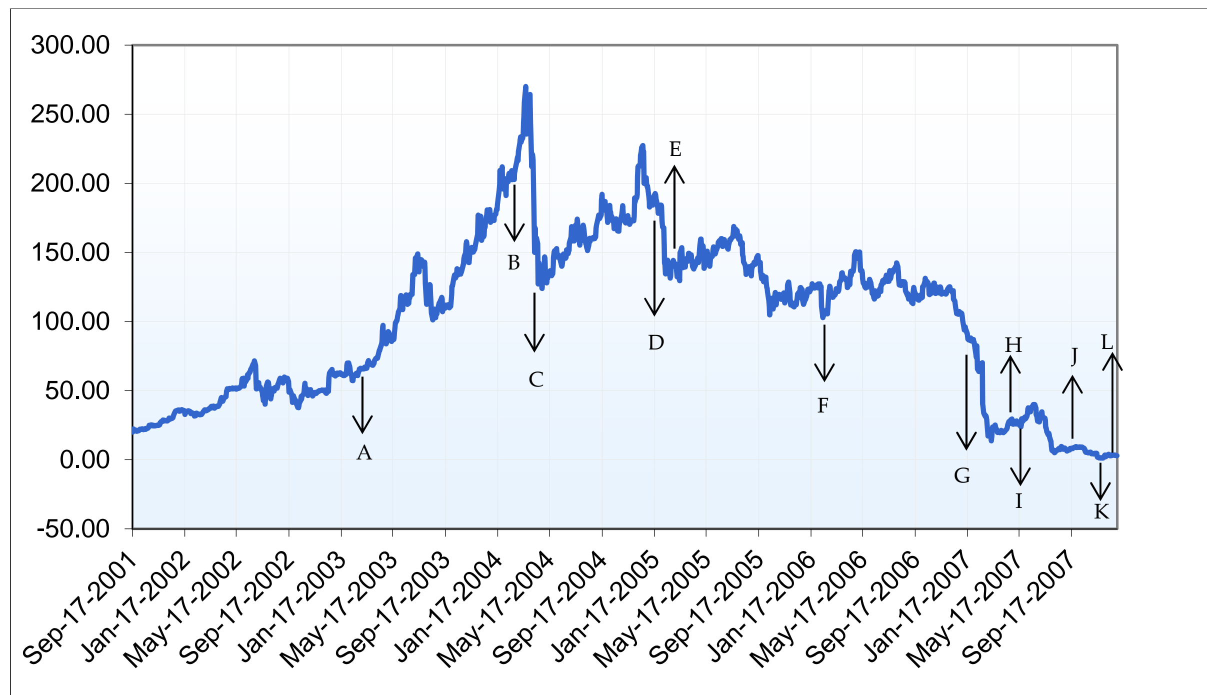
Source: NovaStar 10-Q's 2002-2006 accessed via www.sec.gov, December 2011.

Exhibit 10 Dividend Analysis

Fiscal year ended December 31	2001	2002	2003	2004	2005	2006
Dividends Paid	**2.8**	**30.9**	**99.3**	**132.3**	**195.8**	**237.4**
Cash from Operations less changes in loans held-for-sale:						
GAAP Change in cash from operations	**(123.9)**	**(953.6)**	**8.3**	**(517.9)**	**(713.4)**	**(3,513.1)**
Add back:						
Originations and purchases of mortgage loans held-for-sale	1,401.6	2,800.4	6,047.5	8,539.9	9,379.7	11,275.9
Proceeds from repayments of mortgage loans held-for-sale	-	-	-	(28.0)	(9.9)	(77.5)
Proceeds from sale of mortgage loans held-for-sale to third parties	(110.9)	(391.5)	(966.5)	(64.5)	(1,176.5)	(2,260.8)
Proceeds from sale of mortgage loans held-for-sale in securitizations	(1,192.0)	(1,532.5)	(5,207.2)	(8,173.8)	(7,428.1)	(5,923.0)
	(25.2)	**(77.2)**	**(117.9)**	**(244.2)**	**51.7**	**(498.5)**
Sufficient to pay dividend?	*No*	*No*	*No*	*No*	*No*	*No*
Add back cash from residual assets and subtract required payments on NIMS:						
Proceeds from paydowns on mortgage securities available for sale	40.2	100.1	200.0	346.6	453.8	327.2
Less: Required paydown on asset backed bonds	(139.4)	(86.4)	(120.1)	(254.9)	(363.9)	(565.2)
	(124.5)	**(63.6)**	**(38.0)**	**(152.6)**	**141.6**	**(736.5)**
Sufficient to pay dividend?	*No*	*No*	*No*	*No*	*No*	*No*

Source: NovaStar 2001-2006 10-K's accessed via www.sec.gov December 2011

Exhibit 11 NovaStar Share Price, Annotated, 2001-2007



Events

A Cohodes begins correspondence with the SEC concerning NovaStar (February 2003)

B Nevada orders Novastar to cease operations in NV after finding its branches were unlicensed (February 2004)

C *Wall Street Journal* article causes 30% sell off in shares; SEC launches informal inquiry (April 12, 2004)

D NovaStar announces it took a $1.06 million charge to shut its branches (January 3, 2005)

E NovaStar raises $48.4 million in subordinated floating rate debentures (March 15, 2005)

F NovaStar announces delay in filing of financials due to tax issues, stock down 12% (February 28, 2006)

G JMP securities downgrades NovaStar to sell at $93 due to weakness in housing market (January 8, 2007)

H NovaStar announces it has hired Deutsche Bank and is considering a sale of the company (April 16, 2007)

I NovaStar reveals plans to terminate REIT status as of January 2008 (May 10, 2007)

J NovaStar cancels rights offering after Deloitte and Touche called for a “going concern” clause (September 4, 2007)

K NovaStar reports $600 million loss in Q3 and raised potential of bankruptcy, shares fall 60% (November 15, 2007)

L CEO and co-founder Scott Hartman and CFO Greg Mertz leave the company (December 2007)

Endnotes

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[10] Interview with Marc Cohodes conducted by case writers December 12, 2011.

[11] Interview with Marc Cohodes conducted by case writers December 12, 2011.

[12] Interview with Marc Cohodes conducted by case writers December 12, 2011.

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[22] Interview with Marc Cohodes conducted by case writers December 12, 2011.

[23] Interview with Marc Cohodes conducted by case writers December 12, 2011.

[24] Morgenson, Gretchen and Rosner, Joshua. *Reckless Endangerment*, New York, NY, Times Books, 2011, p 202.

[25] Morgenson, Gretchen and Rosner, Joshua. *Reckless Endangerment*, New York, NY, Times Books, 2011, p 204.

[26] Morgenson, Gretchen and Rosner, Joshua. *Reckless Endangerment*, New York, NY, Times Books, 2011, p 208.

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[29] Weil, Jonathan. "Outside Audit: NovaStar's Rise Has Ring of Deja-vu – Lender's Licensing Woes in Nevada, Other States May Flag Larger Concerns," *The Wall Street Journal,* April 12, 2004, accessed via Factiva September 16, 2011.

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[32] Interview with Marc Cohodes conducted by case writers December 12, 2011.

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[56] "The Community Reinvestment Act: Its Evolution and New Challenges" Speech given by Ben Bernanke on March 30, 2007 at the Community Affairs Research Conference, Washington, D.C.

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[59] “The Community Reinvestment Act: Its Evolution and New Challenges” Speech given by Ben Bernanke on March 30, 2007 at the Community Affairs Research Conference, Washington, D.C.

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EXHIBIT 2

Interview of Marc Cohodes on Business News AM – "Short Seller Takes Aim at Concordia"
April 29, 2016 7:30 AM

http://www.bnn.ca/video/short-seller-takes-aim-at-concordia~859434

Francis: "The long game of the short seller. That's where we go to now with Marc Cohodes. He's a 30-year veteran of the other side of the market. That's the short side with considerable experience in the Canadian equity market over the years as well. He's sells short stock for himself and his family alone. He's in San Francisco to discuss his philosophy. Marc, nice to see you."

Marc: "How are you doing Francis?"

F: "I'm great thank you very much. I had a whole series of things I wanted to start with, but I have to start with this tweet that, um, Amber Kanwar sent out this morning. It comes from the Concordia annual general meeting and I think it's directed very specifically at you. 'If you are a chicken farmer, your chickens will come home to roost' This comes from Mark Thompson, the CEO of Concordia. And just as background you are a chicken farmer at this point in your life. You do a lot of other things, but you do have chickens. What's your response to Mr. Thompson?"

M: "Oh I love that Francis. Thank- thank God we're starting this off as I would say 'hot'. One of the things I always try to do is I bet the jockey and not the horse. And one thing I look at is I look at career failures and the management of Concordia…their past, their past gig was at something called Biovail, which I was short a long time ago which was a complete and utter fraud. So Thompson has a history of nonsense when he was at Biovail. He started up a company called Trimel Pharmaceuticals. I last quoted that at 18 cents. And for a guy who pays himself 9 million dollars U.S. a year and as leveraged as he is he should focus a little more on running his business and a little less on me."

F: "Let's turn to some of the controversies around you first and then we'll get to the Concordia and your short playbook as well because uh because uh there have been some allegations that you and other short sellers have been involved in what some people call short and distort on Concordia, but also on Nobilis Health is that true?"

M: "Well I don't even know the symbol of Nobilis health and in terms of short and distort on Concordia, I have a twitter account @alderlaneeggs. I've always called Concordia the poor man's Valeant. Uh, I'm here today, I don't hide from anyone, I'm not scared of anyone. I would love to talk to the regulators and people who are interested in Pharmacy pricing and I will talk about how Concordia gouges the U.S. consumer and especially the consumer over in the U.K. So there's no short and distort with me. I've never been accused of such. Um, I'm here, I don't hide, I don't use pseudonyms and, you know, my life has been threatened I think 3 times. My son, who's disabled, his life's been threatened once, and this is what you get for speaking out against complete and utter nonsense…and frauds."

F: "Let's move back to your short thesis. We're just looking at uh the Concordia short position which hasn't budged despite the fact that the company is looking at strategic options, but let's just stick with Concordia though, a couple of issues in particular. What do you think about the uh creation of the committee at Concordia to look at strategic options in the reviews - or the rumors, excuse me - last week that Black Stone was interested in making an offer?"

M: "Well I don't think Black Stone is interested in making an offer, I think Concordia is desperate for money. They're desperate to get their stock up. I think someone from Concordia or a shareholder of Concordia leaked this information to Bloomberg. I think at the end of the day they're probably gonna have to sell that preferred they talked about to raise money because I think their cash flows will come up short and basically something that really turns me on and I'm attracted to are failed overleveraged roll-ups run by very, very, very weak operators and that's exactly what Concordia is. They've overpaid for assets, after they buy these assets they've raised prices. I've done some analysis and I'll be very happy to share it with BNN and your viewers that the CAGR, the compound annual growth rate, of Concordia's drugs in the U.S. is up 58.8% over the past-"

F: "And we're talking drug prices is what we're talking about?"

M: "Yeah we're talking about drug prices. We're talking about they hauled Pearson and Schiller and Ackman's ass into Congress or the Senate the other day scolding them about price gouging and it's exactly what Concordia does in the U.S."

F: "Yeah Marc some people argue though that they have just brought prices up to level at which other competitive products are already at."

M: "You see that's, that's what they'll say. I'm very happy to furnish you with the prices and everyone can look at them. Everyone can come to their own conclusions and whatever the market decides, the market decides. The market is a court of public opinion, it's not a court of law and the evidence that I have shows Concordia as a price gouger both in the U.S. and in the U.K. and they're so highly leveraged they decided to take a Valeant copycat model and when Valeant's stock was going up it was very, very, very convenient for Concordia to call themselves the next Valiant. That's what they did in their presentations. And they even went as far as to say some of the executives worked at Valeant. Well they never did. No, there was a guy named McCreary or something like that and he worked at Biovail. There's no record in his LinkedIn that he ever worked at Valeant, and yet they all claim Valeant's success when Valeant goes up. When Valeant goes down they want nothing to do with Valient."

F: "Marc and so I'm going to interrupt you because we are going to take a quick break. We're going to come back with more because I know that's Concordia's hot button with you, but I also want to talk about Canadian housing, the other hot button! We'll be back with Marc Cohodes after this quick break."

EXHIBIT 3

EX-99.1 2 a2186206zex-99_1.htm EXHIBIT 99.1
QuickLinks -- Click here to rapidly navigate through this document

Exhibit 99.1

June 5, 2008
Dear Fellow Shareholder of Biovail Corporation,

You now face a critical decision about the future of your Company. In May, you received a Management Proxy Circular that outlined the steps your Board is taking to create sustainable long-term shareholder value at Biovail. More recently, Eugene Melnyk, a significant shareholder and the Company's former Chairman and CEO, mailed a Dissident Proxy Circular which includes the list of individuals he has nominated in order to take control of your Board of Directors and your Company.

In his Dissident Circular, Mr. Melnyk also makes a number of unfounded and misguided attacks on your Company, its Board, its management and its strategy. To help you make a decision based on facts, we correct the more significant errors and omissions in detail in this letter.

Mr. Melnyk does not offer a realistic strategy for enhancing shareholder value. He would simply like to turn back the clock by more than a decade. He uses the Company's performance from the 1990s as an argument to return to a Melnyk-dominated "Old Guard" now — while ignoring the reality of significant change in both the pharmaceutical industry and the capital markets in the intervening years.

Mr. Melnyk prefers to look at what he calls the "golden years" but not what can rightly be called "The Lost Years" at Biovail — the period from 2001 to 2007 when he was CEO or Chairman or both. It was during this period that Biovail lost much of its competitive position, its product pipeline and its shareholder value. While Mr. Melnyk was a senior executive of Biovail until just four months ago, he ignores his own central role in creating the operating, financial and legal challenges that your current Board is successfully addressing today.

Nostalgia is not a strategy. Selective memory is not management. And allowing Biovail to be controlled by Eugene Melnyk is not in the best interests of Biovail shareholders.

Your Board of Directors unanimously recommends that you:

- **Vote FOR All of Biovail's Proposed Resolutions, including the Company's Nominees to the Board**
- **Reject the Melnyk Nominees**

Vote only the BLUE proxy

Do NOT use the yellow dissident proxy

The Board believes that the election of the Melnyk nominees is not in the best interests of all Biovail shareholders. The reasons for this conviction are detailed in the following pages.

In summary:

- **Eugene Melnyk is attempting to take control of Biovail without paying you for it**

  By placing his hand-picked nominees on the Board, Eugene Melnyk could exercise effective control over Biovail.

- **Eugene Melnyk is the problem Biovail is trying to solve — not the answer**

  The strategic and operating challenges Biovail is addressing now stem directly from the actions — and inaction — of Eugene Melnyk when he led the Company.

- **The Biovail nominees bring more expertise, more independence, and better corporate governance experience to the Board than the Melnyk nominees**

  The Melnyk nominees represent a potential return to the Lost Years at Biovail.

- **Biovail's current Board and Management are taking action to implement a viable and effective strategy to create sustainable shareholder value**

  The Melnyk nominees are tied to a vague, archaic and poorly conceived plan that does not reflect the realities of the pharmaceutical industry today

Your choice:

Prior to Biovail's annual meeting on June 25, you must decide between the Company's independent and experienced nominees to the Board and Mr. Melnyk's hand-picked slate.

The decision you make will be important — but we believe it is not a difficult choice.

CHOICE: ***Accept — or reject — Eugene Melnyk's attempt to gain control of Biovail without paying you***

Biovail shareholders should be under no illusions that Mr. Melnyk's efforts are anything other than an attempt to take over their Company. While his settlement of suspicious trading allegations with the Ontario Securities Commission precludes him from serving as a director of the Company for several more weeks, he has selected his nominees to serve his interests.

- By gaining control of the Board, Mr. Melnyk would effectively gain control of the direction of the Company without any compensation being paid to other shareholders. In most takeovers, shareholders receive a significant premium to the current share price in exchange for handing over control of their company. Mr. Melnyk is offering nothing.

- The majority of the Melnyk nominees have reported to Mr. Melnyk in the past and there can be no assurance that they will not continue to be influenced by him.

- Three of the Melnyk nominees worked for Mr. Melnyk at Biovail before resigning. Two others are external legal counsel hired by Biovail while Mr. Melnyk was running the Company. Others have had past business relationships with Mr. Melnyk or Bruce Brydon, Mr. Melnyk's choice as a new CEO.

- Through his nominees, Mr. Melnyk could influence the Board but, if he chooses, he could also become more directly involved by having his nominees place him on the Board or into a management position within

a matter of weeks. Given Mr. Melnyk's past record, Biovail shareholders should be concerned that this would not be in their best interest.

- By gaining control of the Board, Mr. Melnyk could reject the Company's recent agreement with the United States Department of Justice. That may be in the best interest of Mr. Melynk, but not of the Company and its shareholders, since it could expose Biovail to criminal indictments.

CHOICE: ***Elect experienced independent directors — or the Melnyk nominees***

Shareholders need to choose between an independent Board with significant public company experience and a commitment to representing the interests of **all** shareholders, *or* a Board personally selected by Eugene Melnyk.

- Your Board's Compensation, Nominating and Corporate Governance Committee undertook a thorough search for capable, experienced new directors who would represent all Biovail shareholders, resulting in the selection of five additional independent director nominees.
- Together with the existing Directors, the new Company nominees to the Board bring the following to Biovail:
    - Significant public company board experience (Company nominees currently have 15 public company board seats, including TSX Group Inc., Gerdau Ameristeel Corporation, Onex Corporation, RONA Inc. and Cott Corporation).
    - Extensive pharmaceutical expertise (five current and former senior pharmaceutical executives).
    - Substantial financial expertise (three senior chartered accountants).
    - Corporate governance experience and knowledge (decades of combined service on public company boards).
    - All are considered independent under legal tests, except Mr. Wells and Dr. Squires as member/past member of management.
- Conversely, Eugene Melnyk has proposed his own slate of hand-picked directors who lack Canadian public company board experience. While his slate has some pharmaceutical experience, their main qualification appears to be having a past relationship with Mr. Melnyk or Mr. Brydon.
- The Melnyk nominees:
    - Most have past or current business or personal relationships with Mr. Melnyk.
    - The Dissident Circular discloses that only one Melnyk nominee, William Menear, currently serves on the board of a Canadian public company.
    - At least three of his nominees will not be "independent" under legal tests.
    - Two Melnyk nominees, Douglas Deeth and Liza Harridyal-Sodha, are lawyers who were retained by Biovail when Mr. Melnyk was Chairman. They agreed to join the dissident slate and did not resign as legal advisors to the Company despite their conflict of interest. Their engagements with Biovail have been terminated.

Compare the slates:

Management Nominees	Melnyk Nominees
Doug Squires — Biovail Chairman, 30+ years in pharmaceutical industry	Bruce Brydon — Retired since 2001, former CEO at Biovail, former director of ViRexx Medical Corp.
Bill Wells — Biovail CEO, extensive management experience in global companies	Robert Podruzny — Private investor, former Biovail CFO under Mr. Melnyk
Lloyd Segal — Chief Executive Officer and Director of Thallion Pharmaceuticals (TSX listed)	Mark Thompson — Lawyer, former associate general counsel at Biovail under Mr. Melnyk
Mark Parrish — Former senior executive of Cardinal Health Inc. (NYSE listed)	Liza Harridyal-Sodha — Barbados lawyer, not independent
Robert Power — Former Executive Vice President of Wyeth Pharmaceuticals (NYSE listed)	Douglas Deeth — Lawyer, not independent
Serge Gouin — Chairman, Quebecor Media, serves on two public company boards	Joseph Krivulka — CEO of Triax, prior business relationship with Mr. Melnyk
Dr. Laurence Paul — Private equity principal and former investment banker, Director of Biovail since 2002	Vince Mazza — Investment advisor, prior business relationship with Mr. Melnyk
David Laidley — Former Chairman of Deloitte & Touche, Director of Bank of Canada and the Fraser Institute	William Menear — Director, Magna Entertainment Corporation, prior business relationship with Mr. Melnyk
Spencer Lanthier — Former Chairman of KPMG Canada, Director on five public company boards	Dr. Lorne Tyrrell — Chair in Virology, University of Alberta, former CEO of ViRexx Medical Corp., prior business relationship with Mr. Brydon
Michael Van Every — Retired Senior Partner PricewaterhouseCoopers, Director of Biovail since 2004	Laurence Zeifman — Partner, accounting firm, acted on a transaction for Biovail when Mr. Melnyk was Chairman

A comparison shows there is no doubt that the Company's nominees to the Board are far more qualified and have the requisite experience to guide Biovail's future direction and to represent the interests of *all* Biovail shareholders.

For more information on the extensive skills and experience of the Company's nominees to the Board, see pages 18 to 23 of Biovail's Management Proxy Circular dated May 9, 2008.

CHOICE: ***Management for today and tomorrow — or yesterday under the Melnyk nominees***

Leading a start-up pharmaceutical company in the 1990s is no qualification for running an established company in 2008.

- The track record of Bruce Brydon as CEO of Biovail between 1995 and 2001 is irrelevant: Biovail and its marketplace are profoundly different than they were 10 years ago.

- While Biovail added important new products during Mr. Brydon's tenure, he is not responsible for all those the Dissident Circular ascribes to him. Further, while he was CEO, Biovail did not ensure proper establishment of the Company's intellectual property which ultimately contributed to the early genericization of Wellbutrin XL and the loss of significant revenue streams.

- Mr. Brydon's more recent corporate experience is not mentioned in the Dissident Circular. He served as a Director of ViRexx Medical Corp. (TSX:VIR) where another Melnyk nominee, Dr. Lorne Tyrrell, was CEO. Together, they oversaw a share price decline of more than 56% between January 2006 and the end of January 2007. They resigned after the intervention of a concerned shareholder in February 2007.

- Mr. Brydon has not actively managed a significant business — in the pharmaceutical industry or elsewhere — since 2001. Biovail's industry has changed dramatically since then. Shareholders could understandably ask if Mr. Brydon has kept pace.

- On the other hand, less than a year ago Mr. Melnyk described the current management and Board of Biovail this way:

> *"We have the finest senior executive team in the industry led by Doug Squires...I immediately knew he was the leader to carry this Company forward...Our Board of Directors is committed to this Company's success — and offers sound corporate governance oversight and procedures." Biovail Annual and Special Meeting of Shareholders, May 2007*

CHOICE: *A Responsible Board and management — or continued avoidance by Eugene Melnyk*

The Dissident Circular focuses on the early years of Biovail under Bruce Brydon but ignores the periods from 2001 to 2004 when Mr. Melnyk was Chairman and CEO of the Company and from 2004 to 2007 when he was Executive Chairman or Chairman. It also ignores the period up until February 25, 2008 when he was President of the Company's principal subsidiary and the individual most directly responsible for product development at Biovail.

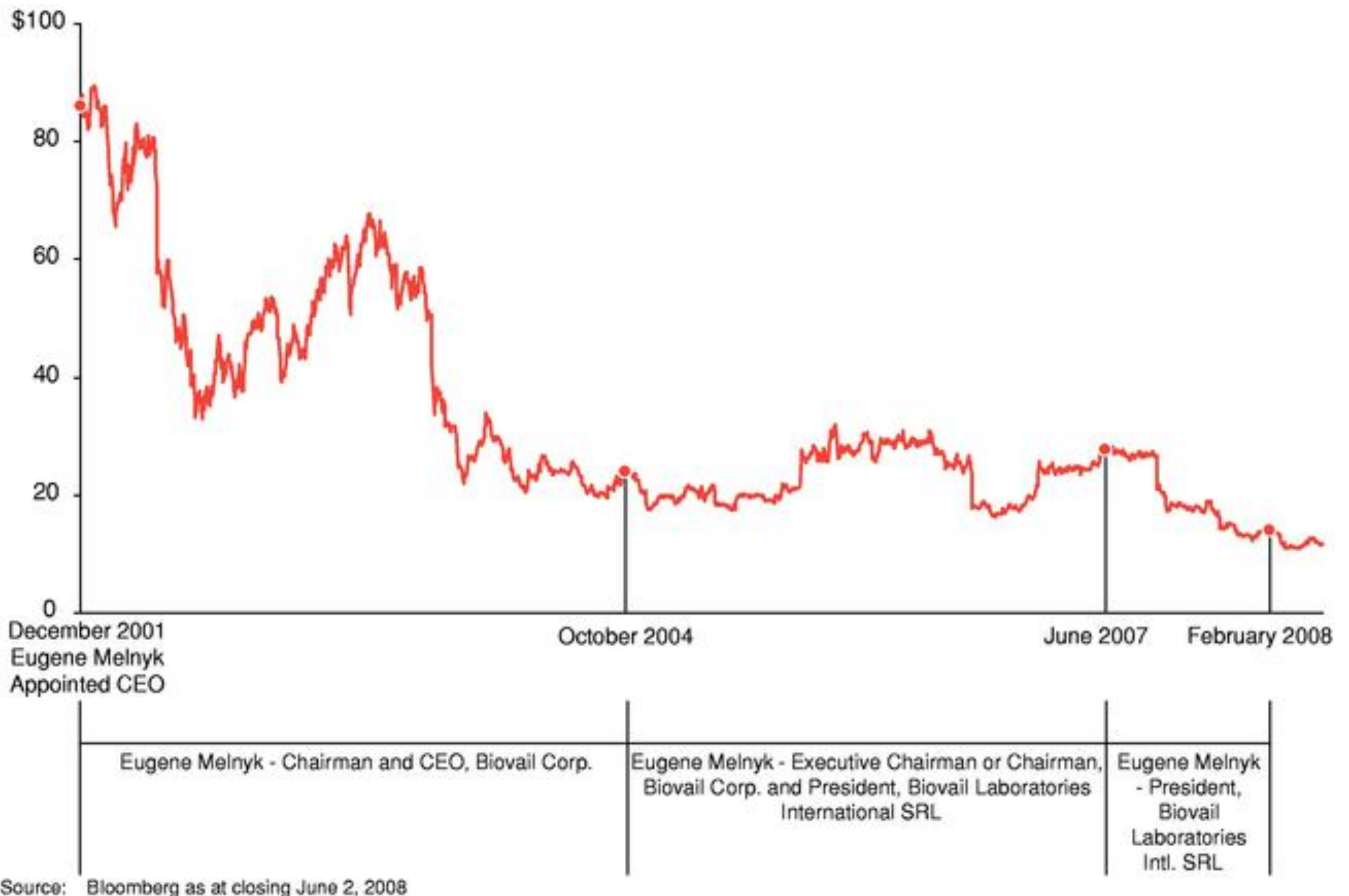
- Between the time Mr. Melnyk took over as CEO in December 2001 and his resignation as CEO in October 2004, Biovail shares lost approximately 64% of their market value — most of the decline he now blames on the current management and Board.

- When Mr. Melnyk criticizes Biovail's Research and Development performance from 2005 to 2008, he is actually criticizing his own management of the R&D function. As president of the Company's principal operating subsidiary, it was Mr. Melnyk's responsibility to direct this effort until just four months ago, when he resigned.

- As most shareholders know, it can take three to five years to move a product through the pipeline from initial development to regulatory approval and sales. While Mr. Melnyk criticizes Biovail for a lack of new products, he does not acknowledge his responsibility for what he now calls the "invisible pipeline" through his own mismanagement of product development over the past several years.

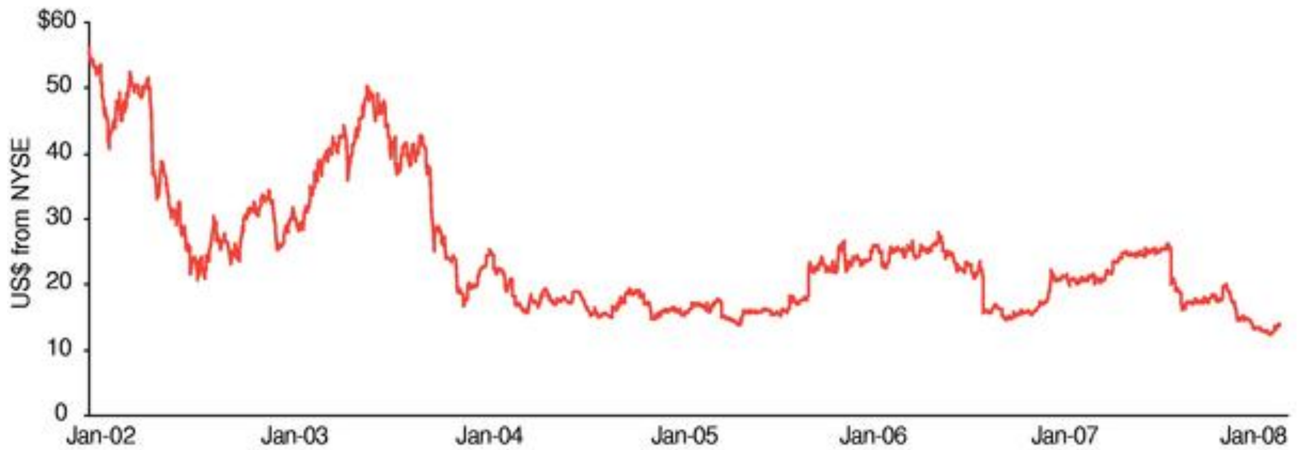
- For example, in the fourth quarter of 2004, when Mr. Melnyk was Chairman and CEO, the Company had 19 products in development. Thirteen of these products failed, were terminated or were never launched. The poor product selection and mismanagement of the pipeline during the Melnyk era are directly responsible for the absence of new products in the past four years.

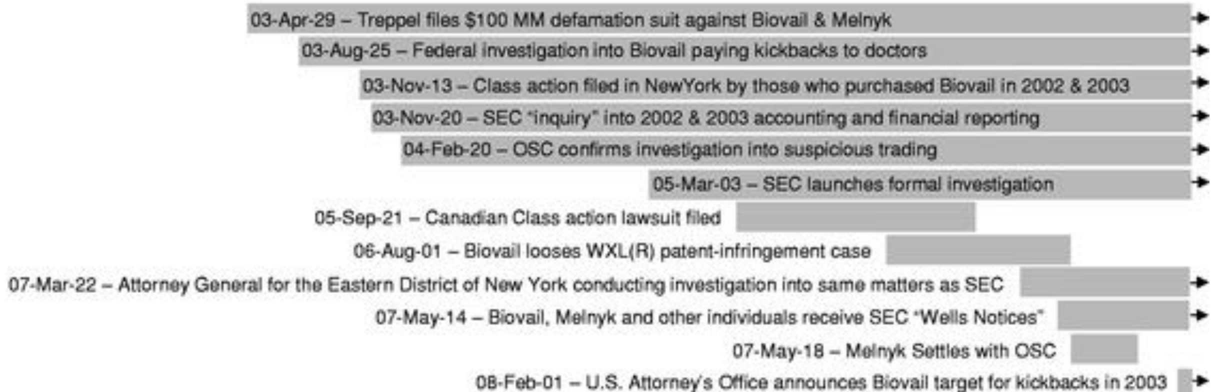
Share Price Performance Under Eugene Melnyk



- It was also during the period when Mr. Melnyk was Chairman and CEO that the Company became embroiled in a number of regulatory and criminal investigations and other litigation which have cost Biovail shareholders more than $175 million, damaged the Company's reputation, and limited its operational flexibility.

Biovail Litigation Relating to Eugene Melnyk's Tenure as CEO





- Further details on Biovail's litigation history, and the efforts of the current Board and management to clear away this legacy are provided in the May 9th Management Proxy Circular.

CHOICE: ***A strategy for Biovail's future — or a return to ill-conceived Melnyk strategies***

Shareholders need to decide between a strategic approach that moves Biovail forward to create sustainable value given CURRENT market dynamics or a Melnyk-influenced Company that looks backward at its so-called "golden years".

With Mr. Melnyk no longer in control of any part of the Company, the Board and management have taken decisive action to move away from the aging, unsustainable business model of the old Biovail to a New Strategic Focus designed to deliver sustainable growth and enhance shareholder value.

Actions of your Board

Over the past year, Biovail has taken a number of steps to move the Company to the next phase of its development. Your Board and management have:

- Completed a thorough, diligent review of a range of strategic alternatives and concluded that Biovail will best serve its shareholders by remaining an independent, publicly traded company and by leveraging its financial strength and core competencies to create value for shareholders.

- Developed a New Strategic Focus that repositions Biovail in an evolving industry, targeting a more focused, leaner and more profitable Company while enhancing sustainable value over the long term. The

New Strategic Focus, as described in the May 9, 2008 Management Proxy Circular, addresses current market dynamics.

- Designed the New Strategic Focus to provide multiple opportunities for higher margins, longer product exclusivity periods, better opportunities for prescription reimbursement, and multiple commercialization options. It builds on Biovail's existing strengths and focuses resources on a large and growing segment of the industry.

- Addressed the significant need to streamline the Company's operations, drive efficiencies and implement strategies that will reduce expenses in the short-term. Mr. Melnyk would suggest that the closing of the Company's Puerto Rican manufacturing facilities is short-sighted (which it is not — this approach has already been discussed with the Company's key commercial partners without issue). Mr. Melnyk's plan, which includes maintaining the dramatically under-utilized Puerto Rican manufacturing facilities, would negatively hurt earnings and cash flow in the short-term and does not include any strategies to reduce expenses.

- Retained Biovail's heritage through a commitment to the Company's current core competencies. As described in the May 9th Management Proxy Circular, the Company will continue to leverage its drug-delivery capability, formulation expertise, and manufacturing excellence. The New Strategic Focus does not abandon the Company's current capabilities, it allows the Company to evolve (as many other specialty pharmaceutical companies have — such as Forest Laboratories and Shire Pharmaceuticals) in a controlled, disciplined manner toward NCE product DEVELOPMENT (not NCE identification) in one of the fastest growing segments of the pharmaceutical industry — CNS.

- Deliberately, after significant analysis and input from advisors, the Company has decided to explore opportunities in NICHE CNS markets where clinical end-points are less subjective and the number of patients required to support an application with the FDA are less onerous.

- Separated the Chairman and CEO roles through the appointment of an experienced and disciplined new CEO to lead Biovail's evolution.

- Eliminated a significant amount of legacy litigation including civil, criminal and regulatory investigations and proceedings stemming from the period when Mr. Melnyk was Chairman and Chief Executive Officer of Biovail. To date, these items have cost the Company over $255 million (approximately $175 million net of insurance coverage).

- Expressed confidence that Biovail's dividend can be maintained while the Company takes the necessary action to position for future growth.

- Diligently sought to add depth to the Board through the identification of five outstanding, fully independent Director nominees.

The Melnyk Strategy: ***Forward into the the past.***

Your Board believes the dissident strategy will result in scattered low-margin opportunities with limited exclusivity periods, limited-to-zero favourable reimbursement opportunity, and a continued dependence on commercial partners. It provides no clearly focused direction and will result in dilution of efforts and key resources.

In fact, the previous, failed business model of Biovail, developed under the Eugene Melnyk regime, failed to keep pace with the evolution of the pharmaceutical industry. The strategies designed under Mr. Melnyk during 2001 to 2004 when he was Chairman and CEO resulted in the gradual erosion of the Company's

competitiveness, resulted in insufficient growth drivers for the period from 2005 to today and created many of the challenges the current Board has been left to deal with.

Mr. Melnyk's "new plan" continues to focus on the antiquated strategy of developing products that primarily provide convenience and compliance benefits (with minimal other competitive differentiation), on competing in the generic segment of the pharmaceutical industry where competition is fierce and if successful, margins are low and on bio-similars which is an uncharted, capital intensive, highly risky, ill-conceived notion. This is not a winning"plan" for today's marketplace.

Overall:

- The Melnyk plan is based on Biovail's past experience in an industry that has changed — and shows no evidence of having learned the lessons from this experience. The strategies of targeting "pharma-similar" and "difficult to genericise products" would continue to confine Biovail to the role of a poorly rewarded middleman needing commercial partners who will demand the lion's share of the value being created.

- The Melnyk plan lacks focus and will overburden Biovail since the Company will have to compete in at least three distinct industries: Generics, Drug Delivery/Formulation, and Biopharmaceuticals. This will result in diluted efforts and underfunding of all initiatives.

- The Melnyk plan of focusing on "Endorsed Dispensed Patient Access Products" is ill-conceived. To the extent these markets exist, they are extremely fragmented, difficult to reach, and required significant investments either in the form of a large sales force or advertising and promotion to create patient awareness of the product and to "drive" them to "ask their doctor".

- Considering bio-similars is perhaps the riskiest, most foolhardy concept of all the strategies. This strategy would require significant capital (possibly putting the attractive dividend policy and the Company at great risk), requires the creation of bioengineered source organisms, would require high risk clinical programs and involves exploring a "yet to be defined" regulatory pathway to achieve FDA approval.

Your Board believes the Melnyk strategy is anchored in the past, ignores the reality of today's environment, and refuses to recognize the consequences of the Melnyk years. It is ill-conceived and lacks focus since it suggests the Company pursue ill-defined opportunities that are poorly suited to Biovail.

The Dissident Circular demonstrates the lack of independence of the Melnyk nominees: They cannot be expected to be independent and serve the interests of all shareholders when Mr. Melnyk is already dictating strategy.

CHOICE: *Strong Corporate Governance — or a return to past practices*

Corporate governance at Biovail is stronger and more responsible to shareholders now than when Eugene Melnyk was Chairman. There can be no assurance that a Melnyk-influenced Board will not return to the Company's former — and inadequate — practices.

- When he was Chairman, Mr. Melnyk held tight control of the Board's agenda and opposed attempts by independent Directors to contribute to strategic planning. Directors were not given access to information that would have strengthened corporate governance.

Current Board practices

- For example, the Board now engages an outside consultant to conduct a Director evaluation process involving interviews and written evaluations with 100% participation by Board members. In addition, at the

request of current leadership, committee and peer-to-peer evaluations are completed. This was not done when Mr. Melnyk was Chairman. He did not want the full report and all feedback, or the reports of compensation consultants, to be viewed by Directors.

- The overall quality of Biovail's Board has been enhanced by the addition of independent directors whose experience and qualifications complement those of the incumbent Board members. Biovail's corporate governance will continue to evolve and improve under the Board's leadership.

- In accordance with good corporate governance practices, Biovail has maintained separate roles for the Company's Chairman and its Chief Executive Officer. The Dissident Circular does not state that the Melnyk nominees would do the same. Shareholders can only speculate about why.

Succession

- Mr. Melnyk unjustifiably criticizes the appointment of Bill Wells as CEO of Biovail. Mr. Wells is a proven business leader recognized for his disciplined approach, his experience in developing corporate strategy, his success in business development, his understanding of good corporate governance, his expertise in maximizing return on capital, and the business insight gained through experience in leadership roles in several global businesses. It was for these qualities that he was invited to join the Board of Directors of Biovail by Mr. Melnyk in 2005. As a member of the Board and Lead Director, Mr. Wells is intimately familiar with the Company, its potential and its challenges. With this Biovail experience, he has been able to immediately fulfill the responsibilities of the CEO.

Executive Compensation

- Mr. Melnyk, as Chairman, personally reviewed the employment agreements and change-of-control provisions of three of the Biovail executives he names. It is disingenuous for him to now criticize them and call them instances of poor corporate governance. The terms of these provisions have been filed and are on the public record.

- The change-of-control provisions in Mr. Wells' contract are consistent with the others and are common in the recruitment of any senior executive for a public company.

- Similarly, Mr. Melnyk is not in a position to criticize other compensation features since, as Chairman, he opposed attempts to introduce pay for performance programs and proposals for the introduction of performance factors in the short term incentive plan. After his departure from the Company, a new short term incentive plan was introduced, which compensates individuals according to defined performance-based criteria.

- The compensation paid to Dr. Squires and Mr. Wells is less than the mid-range for comparable positions according to the independent consultants engaged by the Board. Mr. Melnyk was the second-highest paid executive at Biovail in 2007, earning total compensation of $1.9 million.

Setting the record straight

The Dissident Circular contains misinformation and a number of other inaccuracies. These include:

Eugene Melnyk says:	**The facts are:**
Biovail's recent strategic review is the Company's third in four years; the first two have resulted in "no meaningful improvement".	It is the first strategic review conducted without Eugene Melnyk. He was Chairman when the first two were undertaken.
In December of 2007, he "methodically walked Dr. Squires and Mr. Wells through each of the Company's publicly disclosed products, many of which were...either technologically infeasible or commercially unviable".	He did not do this and it is not logical that he would since he was responsible for the development of these products.
"...between 2005-2008, Biovail spent on average $100 million a year on R&D and the small but effective R&D group morphed into a bloated structure which included a development committee comprised of an unconscionable 24 voting and non-voting members."	The 24-person committee was created when Mr. Melnyk was responsible for R&D. It operated under a Melnyk appointee who has since left Biovail. The committee was disbanded in 2006.
The closing of the Puerto Rico operations is "ill-advised".	These plants are currently operating generally at less than 25% of capacity, losing approximately $29 million per year, and lost $93 million between 2003 and 2007.
"...anyone with any understanding of the pharmaceutical industry would no doubt agree with" comments from Credit Suisse analyst Marc Goodman's comments.	They don't: — "*We believe the changes at Biovail were needed as current technologies did not provide any additional product or cost advantages.*" Claude Camiré, Paradigm Capital, 05.09.08 — *"We applaud this strategy as it is likely the only way to create a sustainable long-term business."* David Steinberg, Deutsche Bank, 05.08.08 — "*We have said for some time that many of the most successful specialty pharma companies are those that have moved away from a strictly reformulation strategy to one that also includes and eventually focuses on NCE/NCE-like drugs that carry improved exclusivity, reimbursement and revenue growth. While this strategy carries greater clinical risk, long term benefits can be obtained.*" Douglas Miehm, RBC, 05.09.08

Eugene Melnyk says:	The facts are:
The compensation paid to Dr. Squires is "inappropriate" and details of his agreement were not publicly filed until Mr. Melnyk complained.	Cash payments to Dr. Squires correspond with the terms of his employment agreement. The details were filed promptly, well within the time limits set by securities law, and not as a result of Mr. Melnyk's complaints.
That Biovail has settled proceedings although Mr. Melnyk believes the Company had "more favourable legal positions".	Mr. Melnyk is largely responsible for the litigation and is unlikely to admit culpability.

In the coming days, Biovail shareholders have an opportunity to choose the direction their Company will take. It will be one of two ways. They can elect a Board that represents their interests and has already taken steps to create value with a new workable strategy and a strong management team. Or they can choose to hand their Company over to the Melnyk nominees and allow Eugene Melnyk to exercise his influence over the Company once again — just when Biovail is emerging from the shadow of the Lost Years under Mr. Melnyk.

There can be no denying the important role of Mr. Melnyk in the creation and early growth of Biovail. But his central role in Biovail's years of lost momentum, lost competitiveness and lost shareholder value is also undeniable.

Mr. Melnyk may wish to recapture his past, but shareholders understand Biovail cannot move forward towards enhanced value by turning back the clock. Shareholders also understand there is no value for them in turning their Company over to Mr. Melnyk.

We urge you to vote in your own best interest and to elect the experienced and independent Biovail Nominees to your Board of Directors.

Yours sincerely,

Dr. Douglas J.P Squires
Chairman of the Board

William M. Wells
Chief Executive Officer

For questions or assistance voting your **BLUE** proxy, call Georgeson toll-free at 1-866-676-3028

YOUR VOTE IS EXTREMELY IMPORTANT — SUBMIT YOUR BLUE PROXY TODAY

Caution Regarding Forward-Looking Information and "Safe Harbor" Statement

To the extent any statements made in this release contain information that is not historical, these statements are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and may be forward-looking information under applicable Canadian provincial securities legislation (collectively, "forward-looking statements"). These forward-looking statements relate to, among other things, the Company's objectives, goals, targets, strategies, intentions, plans, beliefs, estimates, outlook and guidance, including, without limitation, statements concerning the Company's New Strategic Focus, including the Company's intention and ability to implement and effectively execute elements of its New Strategic Focus, the anticipated impact of the Company's New Strategic Focus, the Company's intentions regarding its dividend policy, the ability of the Company to resolve legal and regulatory matters and the expected impact of the resolution of these matters, and can generally be identified by the use of words such as "targets", "guidance", "believe," "anticipate," "expect," "intend," "plan," "will," "may" and other similar expressions. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements.

Although Biovail believes that the expectations reflected in such forward-looking statements are reasonable, such statements involve risks and uncertainties, and undue reliance should not be placed on such statements. Certain material factors or assumptions are applied in making forward-looking statements, including, but not limited to, factors and assumptions regarding the election of Biovail's slate of directors at its upcoming shareholders meeting, prescription trends, pricing and reimbursement in the therapeutic area of focus the Company selects, timelines associated with the development of, and receipt of regulatory approval for, the Company's products, the competitive landscape in the markets in which the Company competes, and actual results may differ materially from those expressed or implied in such statements. Important factors that could cause actual results to differ materially from these expectations include, among other things: the difficulty of predicting U.S. Food and Drug Administration, Canadian Therapeutic Products Directorate and European regulatory approvals, acceptance and demand for new pharmaceutical products, the impact of competitive products and pricing, new product development and launch, reliance on key strategic alliances, availability of raw materials and finished products, the regulatory environment, tax rate assumptions, the outcome of legal proceedings and settlements thereto, fluctuations in operating results, the availability of capital and satisfaction of applicable laws for dividend payments, the proxy contest in connection with the election of the board of directors at the upcoming shareholders meeting and other risks detailed from time to time in the Company's filings with the U.S. Securities and Exchange Commission and the Canadian Securities Administrators, as well as the Company's ability to anticipate and manage the risks associated with the foregoing. Additional information about these factors and about the material factors or assumptions underlying such forward-looking statements may be found in the body of this news release, as well as under the heading "Risk Factors" contained in Item 3(D) of Biovail's most recent Annual Report on Form 20-F.

The Company cautions that the foregoing list of important factors that may affect future results is not exhaustive. When relying on Biovail's forward-looking statements to make decisions with respect to the Company, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. Biovail undertakes no obligation to update or revise any forward-looking statement.

Biovail Shareholders: The Proxy to Vote is Blue

Your Company is at a crucial juncture in its history and needs your participation in deciding whether Biovail moves forward or backward. Your vote is important, regardless of how many shares you own.

We urge you to carefully consider the implications of your vote and to submit your BLUE proxy today in favour of the election of the slate of director nominees set out in the Management Proxy Circular.

The Annual Meeting of Shareholders will take place on Wednesday, June 25, 2008 at 10:00 a.m. at Grand Banking Hall of The Suites at King West, 1 King Street West, Toronto. We hope that you will be able to attend in person, but whether or not that is possible, we encourage you to participate in this important process and vote by completing and submitting the BLUE proxy. We have enclosed a duplicate copy for your convenience.

Voting is a quick and simple process. To be sure your vote is counted completed BLUE proxies must be received by 10:00 a.m. on June 23, 2008. Due to the limited time available, we recommend voting by internet, telephone or fax today or no later than 24 hours before the deadline.

Shareholders with questions or needing assistance in voting their BLUE proxy are encouraged to call Biovail's Proxy Solicitation Agent, Georgeson at:

North American Toll-Free: 1-866-676-3028
Bank and Broker and collect calls accepted: 1-212-440-9800

Even if you have already voted using the dissident proxy, you have every right to change your vote simply by executing the BLUE form of proxy: It is the later-dated proxy that will be counted.

Shareholders are advised to review Biovail's Management Proxy Circular, dated May 9, 2008.

Please discard any proxy or related materials you may have received from the Dissidents and vote using only the control number on the accompanying BLUE form of proxy.

QuickLinks

[Exhibit 99.1]

[Share Price Performance Under Eugene Melnyk]
[Biovail Litigation Relating to Eugene Melnyk's Tenure as CEO]
[Biovail Shareholders: The Proxy to Vote is Blue]
[North American Toll-Free: 1-866-676-3028 Bank and Broker and collect calls accepted: 1-212-440-9800]

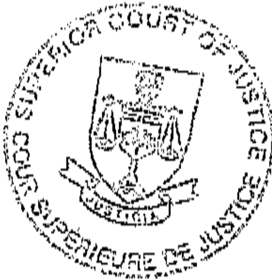
EXHIBIT 4

CV-16-555861
Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

MARK THOMPSON



Plaintiff

- and -

MARC COHODES

Defendant

STATEMENT OF CLAIM

TO THE DEFENDANT

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the plaintiff. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a Statement of Defence in Form 18A prescribed by the Rules of Civil Procedure, serve it on the plaintiff's lawyer or, where the plaintiff does not have a lawyer, serve it on the plaintiff, and file it, with proof of service, in this Court Office, **WITHIN TWENTY DAYS** after this Statement of Claim is served on you, if you are served in Ontario.

If you are served in another Province or territory of Canada or in the United States of America, the period for serving and filing your Statement of Defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a Statement of Defence, you may serve and file a Notice of Intent to Defend in Form 18B prescribed by the Rules of Civil Procedure. This will entitle you to ten more days within which to serve and file your Statement of Defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU.

IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

IF YOU PAY THE PLAINTIFFS' CLAIM, and $5,000.00 for costs, within the time for service and filing your statement of defence you may move to have this proceeding dismissed by the court. If you believe the amount claimed for costs is excessive, you may pay the plaintiff's claim and $400 for costs and have the costs assessed by the court.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

Date: June 30, 2016

Issued by:

Address of court office:
393 University Avenue
10th Floor
Toronto, Ontario

TO: **MARC COHODES**
Alder Lane Farm
1050 East Railroad Ave
Cotati, California
United States of America
94931

CLAIM

1. The plaintiff claims:

(a) general damages for libel in the amount of $2,000,000.00;

(b) aggravated damages for libel in the amount of $1,000,000.00;

(c) punitive damages in the amount of $1,000,000.00;

(d) a permanent injunction restraining the defendant or any other person acting on behalf of the defendant from publishing, posting, or reposting any communications defamatory of the plaintiff;

(e) prejudgment interest on damages awarded to the plaintiff pursuant to the *Courts of Justice Act*, R.S.O. 1990, c. C.43;

(f) the costs of this action on a full indemnity basis; and

(g) such further and other relief as this Court may deem just.

1. THE PARTIES

2. The plaintiff, Mark Thompson, is the founder, a Director, Chairman and Chief Executive Officer of Concordia International Corp. ("Concordia", formerly named Concordia Healthcare Corp.). Mr. Thompson is the former Senior Vice President and General Counsel of Legacy Pharma Limited Partnership, and co-founder of Trimel Pharmaceuticals and Tribute Pharmaceuticals Inc. From 2001 to 2005, Mr. Thompson was employed by Biovail Corporation ("Biovail"), where he was Associate General Counsel and, subsequently, Vice-President, Business Development. Prior to joining Biovail, Mr. Thompson was an associate at Osler,

Hoskin and Harcourt LLP. Mr. Thompson holds H.B.A. and M.A. degrees from York University and an LL.B. from the University of Ottawa.

3. The defendant, Marc Cohodes, is a businessman who resides in the State of California in the United States of America. He carries on business there and elsewhere in North America.

4. Mr. Cohodes has been active in North American securities markets for many years as a "short seller" of publicly traded securities. A short seller is a person who trades in securities with a view to profiting from a future decline in the securities' market value.

5. Generally, a short seller of securities borrows securities and sells them. In doing so the short seller hopes to satisfy the seller's obligation to the lender by purchasing equivalent replacement securities in the future for a lower price. If the short seller has sold the borrowed securities for more than it costs to replace them, the difference is profit in the short seller's hands.

6. The short seller's strategy can only succeed if the market price of the borrowed securities declines after the short seller's sale of them. It is thus in the interest of a short seller of a company's securities to spread information in the public markets which will lower the reputation of the company and its senior management, and thus contribute to the market placing a lower value on the company's securities.

2. THE LIBEL COMPLAINED OF

7. Mr. Cohodes is a short seller of Concordia. To advance his financial interests as such, he has launched a campaign to manipulate downward the price of Concordia shares by,

among other things, criticizing Mr. Thompson as the Chairman and Chief Executive Officer of Concordia.

8. In furtherance of his campaign, on Friday, April 29, 2016, Mr. Cohodes appeared on a national Canadian television broadcast on the Business News Network ("BNN"). Thereafter, the broadcast continued to be available on the Internet at BNN's website, a popular source of business news, under the title, "Short seller takes aim at Concordia".[1]

9. During the broadcast Mr. Cohodes falsely and maliciously made the following statement regarding Mr. Thompson:

> One of the things I always try to do is I bet the jockey and not the horse. And one thing I look at is I look at career failures. And the management of Concordia, their past gig was at something called Biovail which I was short a long time ago which was a complete and utter fraud. So Thompson has a history of nonsense when he was at Biovail.

In the interview Mr. Cohodes went on to say that in his statements about Mr. Thompson and Concordia he was "speaking out against complete and utter nonsense and frauds".

10. Mr. Cohodes' statements in the BNN interview are false and seriously defamatory of Mr. Thompson. The statements, in their plain and ordinary meaning including their implied meaning, meant and were understood to mean that Mr. Thompson had committed fraud, or participated in committing fraud, during his employment with Biovail.

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[1] At http://www.bnn.ca/Video/player.aspx?vid=859434.

3. Damages

11. Mr. Thompson has suffered damage to his reputation and feelings as a result of the false and defamatory statements of the defendant.

12. Mr. Cohodes made the statements complained of maliciously, for the dominant purpose of harming Mr. Thompson's reputation, with knowledge that they were false or reckless disregard for their truth or falsity.

13. Mr. Cohodes made the statements as part of a campaign to damage the reputation of Mr. Thompson for the collateral purpose of reducing the market value of Concordia's securities, so as to advance Mr. Cohodes' private financial interests as a short seller of Concordia shares.

14. Mr. Cohodes sought to maximize the breadth of the publication of the statements complained of by making the statements in a broadcast on national television, which was also published internationally through the Internet.

15. By letter dated May 4, 2016, Mr. Thompson put Mr. Cohodes on notice of the libels stated above. Mr. Thompson asked Mr. Cohodes to retract and apologize for the libels. Mr. Cohodes has refused to retract the defamatory statements or apologize to Mr. Thompson.

16. In April of 2016 and since that time, Mr. Cohodes' defamatory statements regarding Mr. Thompson have been republished on the Internet. The wide republication of the defamation of Mr. Thompson was a direct result of Mr. Cohodes' statements for publication and was reasonably foreseeable by Mr. Cohodes and intended by him.

17. The malicious, high-handed and arrogant conduct of the defendant warrants an award of punitive or exemplary damages to ensure that the defendant is appropriately punished for his conduct and deterred from such conduct in the future.

18. The plaintiff requests a permanent injunction restraining the defendant or any other person acting on behalf of the defendant from publishing, posting or reposting any communications defamatory of the plaintiff, as there is a likelihood that the defendant will continue to publish defamatory statements despite a finding of his liability to the plaintiff in this action.

19. The plaintiff is entitled to serve this originating process outside of Ontario as his claim consists of a claim in respect of a tort committed in Ontario and is for, among other things, an injunction ordering the defendant to refrain from defaming the plaintiff in Ontario. The plaintiff relies on Rules 17.02 (g) and (i) of the *Rules of Civil Procedure*.

The plaintiff proposes that this action be tried at the City of Toronto.

June 30, 2016

FASKEN MARTINEAU DUMOULIN LLP
Barristers & Solicitors
333 Bay Street, Suite 2400
Bay Adelaide Centre, Box 20
Toronto, Ontario
M5H 2T6

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LSUC 25754W
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Fax: 416 364 7813

Lawyers for the plaintiff

MARK THOMPSON - and - MARC COHODES

Plaintiff Defendant

Court File No. CV-16-553861

ONTARIO
SUPERIOR COURT OF JUSTICE
Proceedings commenced at
Toronto

STATEMENT OF CLAIM

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