Svenda's Manual of OTC Stocks

SAMPLE VERSION

Written by Jan Svenda, published on 17/10/2018

Disclaimer

Please be aware that the following compilation of reports should not be treated as an investment advice. The content is solely for informational purposes. The author is also not compensated in any way by companies highlighted below. Refer to the terms and conditions for full disclosure.

The author could be a shareholder of some of the companies highlighted below. Disclosure about his positions at publication date of the *reports* can be seen at the end of each report.

Main Navigation of the Document

Foreword

First of all, I would like to thank you for showcasing interest in my research. I greatly appreciate it!

For the past year and three months, I ran a newsletter focused solely on the Over-The-Counter (OTC) market in the US.

During this time, I scoured the notoriously inefficient market for companies that are meaningful and exhibit an investment opportunity. No frauds, no pump and dumps. Only companies that are of interest for the serious *enterprising* investor (I tip my hat to Mr. Graham).

I like to think that I looked at every company on the OTC market at least twice. I went the A to Z route a couple of times, I maintained many simple screeners, I tracked Form 25s, 15s, and much more. Given the sheer size of the market, one can't be completely sure of his/her coverage of the market, but I believe my reach is formidable.

As I expected, I stumbled upon many completely forgotten businesses that seemed either undervalued on the basis of their tangible book, cash flow or exhibited a special legal opportunity that one can take an advantage of. The following document is a compilation of my effort.

In this manual you can find 351 stocks from the OTC land mentioned in 86 reports over 402 pages. These are meaningful businesses with some kind of fundamental value that investors should be able to analyse.

The OTC investor can use this document as a starting point for the search for the next investment opportunity. One can pile through the summaries of the reports which point to specific opportunities within mentioned stocks.

Alternatively, he/she can use this document as an encyclopaedia. Within the index of stocks one can quickly identify stocks that one owns, wants to own, or always wanted to research but did not have the time to delve into. Due to the sheer size of the manual's coverage, the document also becomes a powerful reference point for any future research of OTC stocks.

I like to say that simply knowing about an OTC stock means you are halfway there. I have talked with many seasoned OTC investors that had no idea about some of the stocks I highlighted in the reports. This can be extremely costly as most of the meaningful OTC stocks will exhibit an investment opportunity at some point in time of their existence. This document will allow you minimize the risk of this.

If you are sceptical about the OTC market and want to know why I believe investing in OTC makes sense, please see the chapter 'How to argue about OTC at parties'.

Finally, as always, buyer beware! Please do your own research before buying any stock and do not use this report as an investment advice. It is merely a guide to parts of the hidden corners of the OTC market.

Acknowledgments

I would like to mention a couple of people that were indispensable in my investing/research journey. Some of the people I have met in real life, but most just through email or Skype.

Firstly, I would like to thank my father for asking which stocks I would invest in 2007 and thus starting my interest in the markets. I picked EA if anyone is wondering (it recovered in mere six years after the crisis).

Secondly, I would like to thank Tom Beevers and Tim Insko of StockViews who gave my great feedback. They taught me how to write investment research, form an investment thesis and most importantly through cooperating with them I was able to form my own view on valuation.

Thirdly, I would like to mention Thomas Braziel, whose brilliant research of Ethanex showed me the potential of the OTC market and got me into this niche.

I would also like to thank investors that have put out a significant amount of public OTC research such as Nate Tobik, Dave Waters, Dan Schum, Geoff Gannon, Safety in Value, or Maj Soudeian and his team over at GeoInvesting.

Fourthly, I would like to thank all members of the OTC investing community.

Among the people I can name are Nick Bodnar, Jim R., Thomas Niel, Ruerd Heeg, Dave A., David C., Eric S., Mark S., Chuck Gillman, Joe Sullivan, Richard K., Anthony W., Todd B., Thinley Wangchuk, Carl H. and many others.

Last but not least I would like to thank many members of Seeking Alpha, Value Investors Club and Corner of Berkshire and Fairfax with whom I routinely interacted and who certainly can't be omitted.

I hope that the whole community will be even more vibrant in the coming years.

Explanation of Report Types

There are four type of reports in the manual.

- Sunday Updates

These updates consist of an initial analysis of many OTC stocks. This initial analysis should be enough to spark interest of the reader to research further and have the key questions / factors of the investment in mind. These reports represent the bulk of the document with 60 reports out of 86 being dedicated to them.

- Company Profiles

Similarly, to Sunday Updates, these reports should introduce an interesting OTC stock. They do so in a bit more structured fashion. I share a simplified investment thesis and my view on key points of research (valuation, catalyst, and capitalization).

- Monthly Performances

These documents served in the newsletter as a large update of stocks that I mentioned in the newsletter. Sometimes this can be just a quick comment on the relevant quarter, but most likely the comment will have a part of the proposed investment thesis as well.

- OTC Interviews

These are interviews with a number of active investors in the OTC space who share their investing experience, strategies and favourite stocks at that time.

Table of Contents (Summaries of Reports)

- Sunday Updates

Companies mentioned
ABENU, DVLN, ADFT, VPGI

Short description of stocks mentioned in the report

I look at ABENU (interesting ethanol producer traded through unusual channel) and DVLN (interesting real estate portfolio). I also share dark financials for ADFT and VPGI.

Companies mentioned

HRZCA, HKNI, WXMN

Short description of stocks mentioned in the report

I look at two 'classic' undervalued stocks.

HRZCA is a local telecom provider which is trading around its tangible book while being profitable and generating cash flow. One should also note that if we take away the deferred revenue from the liabilities there is a significant discount to tangible book as the book increases to roughly $90 million while market is roughly $20 million.

The second stock (HKNI) is an undervalued NOL shell with a majority shareholder in control. While the usual risks of NOL shells apply, it is going to be likely interesting to track the developments.

Finally, I also share financials of Waxman (WXMN) the company that forces people to sign NDA. I was able to get my hands on financials from 2011 but I believe that the situation could still be the same and thus buying several shares might be worthwhile.

- Monthly Performance Reports

October 2017 Monthly Performance

Companies mentioned

ALYE, SORT, CCNI, CAGU, EVRC, PDRX, RAFI, STRI, DTRX, DYAI, ESCC, GRST, KDUS, HMTC, IARE, ITEX, APTL

I provide updates for various stocks mentioned in the newsletter.

- OTC Interviews

Interview with Geoff Gannon

Companies mentioned

KEWL, RSKIA, PCOA, OSPT, PARF, TNRK, CSVI, PDER

Short Description

This time I interview a seasoned investor and long-time investment writer Geoff Gannon. Geoff has been focused on value investing for the past 20 years. In that time he wrote for different outlets as well as his own newsletters and his blog. In that time, he frequently ventured into the OTC land and most of the time focused on small-caps.

- Company Profiles

Company Profile #1

Companies mentioned

PDER, BSHI

Short description of stocks mentioned in the report

I look at PDER, a promising resource asset play trading below tangible book and BSHI, a simple profitable business also trading at an attractive valuation.

Sunday Updates

Sunday Update

01/10/2017

Welcome to my regular Sunday update where I look back at the content added over the past week, as well as several interesting reports/links or mention anything that would be of interest for you as a subscriber.

Advanced Bioenergy (ABENU)

This ethanol producer operating two facilities caught my eye because of the following two points.

First, it is the valuation. The stock is 'trading' slightly below tangible book while it has been able to produce almost $8 million in free cash flow just in the past six months. The company also owns both facilities and thus given the operations they could be worth multiples of the current market cap. They also seem to redistribute profits to the shareholders when the company earns net income. For example in the past six months, they paid a distribution worth roughly 15% of the current market cap. Moreover, their balance sheet is clean, they owe roughly $24 million but also hold $17.4 million in cash which clears out any potential issues.

The second reason is tied to the fact that I had to put trading into quote marks. The stock does not seem to trade through the regular channels and none of the common providers of financial data have the trading history of the stock (even OTCmarkets.com). Instead, the stock is traded on a website called agstocktrade.com which seems to specialize in matching buyers and sellers of 18 niche agricultural stocks. The website looks to act as your usual broker-dealer and the process does not seem to be anything out of the ordinary (the registration also seems easy).

The stock ticker is for example also missing on SA and it does not seem that many people would know about the company given the few google results. This is probably strengthened due to the way it is being traded. This then creates features that are the reason why OTC can be a lucrative sector. The shares might be illiquid and obscure thus making it a perfect spot for an interesting opportunity.

While there are some risks, namely the company structure (it is an LLC and thus investors need to understand how the company behaves) and the likely exposure to the commodity volatility, I believe that researching ABENU further should at least yield an interesting lesson if not an investment opportunity.

DVL Inc. (DVLN)

This company is a peculiar mix of investments connected to real estate. It owns two real estate projects in New Jersey one of which is now leased by K-Mart and the other one was finished in late 2016 and now awaits to be sold or perhaps leased. It also owns several portfolios of securitized assets such as account receivables that provides DVLN with relatively stable cash flow and finally it holds a mortgage loan receivable.

While the business seems as an obscure mix of assets, the company can produce meaningful positive cash from operations ($2.7 million in past year) and the balance sheet is relatively clean as most of the debt is connected to and backed by the assets. The stock is now trading around the tangible book but given the nature of the business the book value is likely over depreciated and thus the real value could be higher.

This could be especially applicable here given the impairment that DVLN took on the newly completed project in New Jersey. This occurred because of site contamination (the place was previously a linoleum factory) that had to be cleaned out. They cut the value of the investment by $20 million (the original value was $65 million) but the sale price might be closer to the original value. Interestingly enough DVLN also recently filed a lawsuit against the previous owner that could yield the $20 million back.

While the shares are illiquid (mainly likely due to the price of one share) there could be several catalysts that could spur buying. First, it might be the sale or at least the lease of the developed Kearny site which could happen anytime. Second, the company might showcase the true strength of cash flow in its next annual report as the previous years were burdened with development costs. This might offset some of the risks and thus push people to bid higher prices.

Finally, I would be curious if the lease by K-Mart is in any way exposed to the troubles that Sears is going through, but apart from that I have not caught something that would significantly increase the risk involved.

ADFT & VPGI Financials

I will share financials of the two dark companies that I added this week. First is Adfitech, financials of which I obtained through contacting the management.

Assets (in millions)	Q2 2017
Cash and Cash Equivalents	$ 2.46
Account Receivables	$ 2.59
Prepaid Assets	$ 0.16
Total Current Assets	$ 5.22
PP&E	$ 8.25
Intangible Assets	$ 0.27
Deferred Income Taxes	$ 1.21
Other Long-term Assets	$ 0.00
Total Assets	$ 14.95
Liabilities (in millions)	
Account Payables	$ 0.38
Notes Payable - Mortgage	$ 0.35
Other Accrued Liabilities	$ 1.28
Total Current Liabilities	$ 2.01
Mortgage Note Payable	$ 7.74
Total Liabilities	$ 9.75
Current Market Cap.	$ 8.21
Tangible Book	$ 3.73

(in millions)	Q2 & Q1 2017	Q2 &Q1 2016
Revenue	$ 10.62	$ 10.01
Compensation and Benefits	$ 8.70	$ 8.45
Depreciation and Amortization	$ 0.21	$ 0.20
Other Operating Expenses	$ 2.35	$ 1.72
Operating Income / Loss	$ -0.65	$ -0.37
Operating Margin	-6.08%	-3.71%
Other Income	$ -0.17	$ -0.18
Any Extra Reccuring Items	$ -	$ -
EBT	$ -0.82	$ -0.55
Tax Provision (Benefit)	$ -0.30	$ 0.06
Net Income	$ -0.52	$ -0.61
Number of Shares	6.565	6.616
EPS	$ -0.08	$ -0.09
Cash Flow From Operations	$ -0.20	$ -0.95
Cash Flow From Investing	$ -0.05	$ -0.10
Cash Flow From Financing	$ -0.17	$ -0.26
Free Cash Flow	$ -0.25	$ -1.05
Change in Cash	$ -0.42	$ -1.30

As you can see the financials are not screaming an obvious opportunity but the operations might have been affected by regulation which temporarily cut portion of the revenue stream in the past year. Thus, the growth might be sustainable and the company might become interesting.

The other financials that I want to share are connected to Velocity Portfolio Group Inc. (VPGI) which I mentioned in the fifth issue.

Assets (in millions)	2016
Cash and Cash Equivalents	$ 1.86
Restricted Cash	$ 2.02
Consumer Receivables	$ 49.30
Other Assets	$ 0.14
Total Assets	$ 53.33
Liabilities (in millions)	
Account Payables	$ 2.46
Accrued Court and Media Costs	$ 4.89
Debt	$ 56.98
Notes Payable	$ 0.07
Notes Payable - Related Parties	$ 8.20
Convertibe Subordinated Notes	$ 1.05
Other Liabilities	$ 0.08
Total Liabilities	$ 73.72
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Current Market Cap.	$ 4.07
Tangible Book	$ -20.40

(in millions)	2016	2015
Revenue	$ 11.78	$ 10.43
Professional Fees	$ 8.81	$ 6.68
G&A Expense	$ 2.50	$ 2.94
Operating Income / Loss	$ 0.47	$ 0.61
Operating Margin	4.00%	5.82%
Other Income	$ -8.36	$ -3.97
Any Extra Reccuring Items	$ -	$ -
EBT	$ -7.89	$ -3.36
Tax Provision (Benefit)	$ 0.02	$ -0.01
Net Income	$ -7.91	$ -3.35
Number of Shares	7.405	0.963
EPS	$ -1.07	$ -3.48
Cash Flow From Operations	$ -1.96	$ -3.43
Cash Flow From Investing	$-20.51	$-12.75
Cash Flow From Financing	$ 23.92	$ 14.85
Free Cash Flow	$-22.47	$-16.17
Change in Cash	$ 1.45	$ -1.32

As mentioned in the report the stock's financials look terrible but when one digs into the report they can understand what is going on. The balance sheet could actually show a positive equity if we take a conservative rate of return on the consumer debt prior to financial crisis. The income statement is impacted by the revenue recognition policy which delays acknowledging significant part of the cash flow.

The latter is perhaps the clearest and it shows what must change before the stock is fully investable in my opinion. One of the key efforts should be to find a reasonable leverage source which would then offset the high-interest loans. That being said in a 'liquidation scenario' where the management would just finish collecting what they have on the book, the equity could easily jump to $10 million (using the conservative estimate) instead of the current negative $20 million.

- Non-listed REITs

The last stock that I added to our watchlist (CCPT) is a peculiar entity. It is a public but non-listed REIT which trades through various brokers and files with the SEC. I have not encountered this type of investment before but it caught my interest because of the factors that I saw in the 'marketplace' and that it is mainly liquidity and obscurity.

The easiest way to buy into these is through the initial offering as there is a limited secondary market which only rarely offers any shares for sale (which might be impacted also by legal framework). This means that the purchase is rather a long-term proposition and it should be clear that the dividends are going to offset this. This means that there is only a narrow type of investors that can come into the market and buy such shares.

Furthermore, many market players scoff at the thought of buying these REIT structures due to their history which quite often points to high fees, conflicts of interest and overall poor performance (even Finra acknowledges the risks). While I believe that this certainly could be true, the broader OTC market is exactly the same and thus there might opportunity to find stocks that do not have any of the previous issues yet are thrown into the 'same bag' by investors.

Financial Disclosure: I do not own any shares in the aforementioned tickers at publication date.

Sunday Update

07/01/2018

Welcome to my Sunday update, this time on a Friday due to Christmas, where I look back at the content added over the past week, as well as several interesting reports/links or mention anything that would be of interest for you as a subscriber. I also add updates about stocks that have recently reported.

Horizon Telcom (HRZCA)

This week’s favourite is this local internet and telecom provider operating in around Ohio. The appeal is straightforward. The company is trading slightly below tangible book while it is cash generative, the asset base is likely overdepreciated (or at the very least certainly not overvalued) and their revenue stream is likely stable due to government grants that HRZCA was able to win.

Moreover, their liabilities are filled with deferred revenue connected to the government grants and thus if one discounts these liabilities (as they are unlikely to be unfulfilled) then the tangible book jumps to roughly $96 million which represents a significant upside when you compared with the current market cap of $20 million.

There are several things to be aware of such as underfunded pension plan (all on balance sheet however) or debt burden which needs to be scrutinized even if the cash flow generation is not an issue. These points however do not seem to justify the current valuation.

I have not found a clear catalyst for the company and given their focus they might not be incentivized to try to change things around, but given the valuation it could be beneficial to try to snap some shares. The volume is tough to come by so setting up a small order might be the best way to start and see whether there is going to be a fill.

This stock also reminds of OTEL, another rural provider, which was covered by Nick on SA.

HKN Inc. (HKNI)

This used to be a relatively active O&G exploration company that had a varying degree of success in the past. Its history even involves a scandal connected to insider trading of George W. Bush who allegedly sold the stock before it reported substantial losses in the 1990's.

Now it holds only small O&G operations which generate a minimum amount of revenue. It has a cash position that currently matches market cap. The market however discounts other investments of the company and that is an oilfield waste processing plant in Alaska, small O&G properties, and an investment in a public company listed in the UK which is focused on offshore oil. The valuation also discounts $113 million in NOLs that the company owns.

This means that we are looking at an entity that is likely an NOL shell waiting to be unlocked. At the current valuation, it is worth having a close eye on the developments. The company did not yet file financials for the past year, but I can't imagine that they would be radically different.

That being said the management likely needs to be closely scrutinized as it seems that there is a shareholder here who has the majority of the votes and as aforementioned the track record of the company is spotty.

Finally, I would point out that, both these stocks are an example of how OTCMarkets.com is imprecise. The two stocks are labelled as dark on OTCMarktes.com, but they do report their audited financials on their website. Either OTCM does not account for these reports and dismisses them as insufficient (do not see a reason for this) or they are not aware of them in the case of HRZCA. Either way, this creates an opportunity for us.

- Financials for Waxman

I have been able to obtain financials from WXMN which has an NDA agreement in place. Unfortunately, the financials are only from 2011 but they provide enough information about the company and show that trying to buy shares is unlikely to be a bad idea given the fact that the company was in the year 2011 trading at a fraction of the tangible book as can be seen below.

Assets (in millions)	2011
Cash and Cash Equivalents	$ 3.67
Trade Receivable	$ 18.25
Other Receivables	$ 1.30
Inventories	$ 12.63
Prepaid Expenses	$ 1.43
Total Current Assets	$ 37.27
PP&E	$ 7.61
Life Insurance Value	$ 4.20
JV Investment	$ 0.77
Other Long-term Assets	$ 1.01
Total Assets	$ 50.87
Liabilities (in millions)	
Short-term Borrowings	$ 15.93
Current Portion of LT Debt	$ 0.35
Accounts Payable	$ 10.57
Accrued Liabilities	$ 5.37
Total Current Liabilities	$ 32.22
LT Debt	$ 0.33
Deferred Gain on Building	$ 0.23
Deferred Income Taxes	$ 1.68
Total Liabilities	$ 34.45
Current Market Cap.	$ 1.91
Tangible Book	$ 16.41

While the balance sheet is interesting, the company did struggle in the year 2011 and had a loss which certainly posed several risks for the company given their debt and cash position.

(in millions)	2011	2010
Revenue	$ 103.90	$ 98.62
Cost of Sales	$ 71.66	$ 66.65
Gross Profit	$ 32.24	$ 31.97
Gross Margin	31.03%	32.41%
Operating Expenses	$ 33.67	$ 31.74
Operating Profit / Loss	$ -1.43	$ 0.23
Operating Margin	-1.38%	0.23%
Other Income	$ -0.64	$ -0.36
EBT	$ -2.07	$ -0.14
Tax Provision (Benefit)	$ 0.21	$ 0.50
Net Income	$ -2.28	$ -0.64
Number of Shares	1.121	1.121
EPS	$ -2.03	$ -0.57
Cash Flow From Operations	$ -4.02	$ 3.03
Cash Flow From Investing	$ -1.65	$ -0.48
Cash Flow From Financing	$ 4.01	$ -3.35
Free Cash Flow	$ -5.67	$ 2.55

The company failed to comment on why the decrease in profitability occurred, but I believe it is unlikely that this meant further trouble for the company, especially since they were able to generate enough cash in the prior year.

I would also point out that the company was not only valued at a tremendous discount to tangible book but also to the revenue stream. While operations might have operated at a loss that year, a business that has $100 million in revenue is simply not worth $1 million. Perhaps another company could use their revenue stream, optimize the profitability and walk away with a company that is able to consistently generate free cash flow. This option is not worth $1 million, perhaps not even $10 million.

Mind you that they recently sold one of their buildings for [$5 million](#).

While all this is exciting the company is controlled by a single family and thus the interest of minority shareholders is unlikely to be of concern for the management, but perhaps one day the value will transpire.

Financial Disclosure: I do not hold shares in the aforementioned companies at publication date.

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Monthly Performances

October Performance

02/11/2017

Watchlist Updates

Important Updates

- ALY Energy Services (ALYE)

The stock almost doubled since it regained compliance with SEC just a few days ago. The financials have shown that they were able to stabilize the situation. While they are still cash strapped, their cash flow seems to be okay for now. The attractiveness, which I originally pointed out, is also still there as the balance sheet is filled with potentially valuable O&G equipment.

While the discount to tangible book is not as striking as before the jump, I believe it would still be worth looking over the stock. The catalyst is clear here, another quarterly report that shows that they can stay afloat and the gap should close. At the very least the equipment should act as a margin of safety.

- Gunther International (SORT)

I have mentioned SORT in the last Sunday update because the company is likely selling one of its subsidiaries and I believe that it could fetch roughly $5 million for the business which would match the current market cap. After the sale, the company would still have the inkjet operations which are profitable and have generated $1.2 million of operating profit last year. They would also have the chance to clean up their balance sheet and pay off the debt (which is not a huge challenge). This should result in increased valuation.

Silky Road Capital, an SA contributor, written a short post about SORT on his blog which summarizes the thesis well.

I will write more about SORT in the next Sunday Update.

- Command Center (CCNI)

This stock has had a muted reaction to the fact that there is going to be a proxy fight which was announced on the 11th of October. While the stock jumped since summer quite significantly there could some upside left if the activists are able to change the management. At the very least it shows that there is potential for value because otherwise the shareholders would not go against the management.

I have not highlighted CCNI before, but in order to get a good overview I would recommend Nick's article from 2015. The first thing I would need to address is the premium to tangible book, but given the proxy fight this is likely not an issue.

- Castle Group (CAGU)

There has been little news about this interesting REIT-like entity but despite that the shares have traded as high as $0.5 per share which was almost 100% upside since I added it to the watchlist. The stock is now back at $0.25 per share, but given the fact that the thesis still holds (which was supported by the guest post of Safety in Value) I believe one should closely scrutinize CAGU.

- Evercell (EVRC)

The stock has not moved while the company released a solid annual report which showcased that their cash flow is still strong and that they might be able to increase their profits going forward as per the CEO's commentary regarding cost structure. While the stock does trade at a premium to tangible book, the share price might head higher if next earnings confirm the outlook.

Usual Updates

- PD-RX Pharmaceuticals (PDRX)

Just a quick update about this long idea from the beginning of September. There has been no news and the share price is still flat. Waiting for next quarterly results.

- Regency Affiliates (RAFI)

Another REIT-like entity that has been trading higher since addition. I believe though that some of the challenges are still in place and thus a greater breakout might come after a new set of financials. Unfortunately, the company is behind in its reporting. Just a few days ago they released their annual report for 2016. While the valuation is still attractive, as was suggested by Tom on SA, I have not been able to catch anything that would resolve any of the outstanding issues (re-lease of main assets etc.).

- STR Holdings (STRI)

STRI is one of the best performers so far. The reason for the move is not entirely clear as it happened before the news that the company put out. It could be partially explained by the chairman's letter which mentioned that they have stabilized cash burn and that they are re-entering the sale process for the Malaysian plant which could potentially realize the value of the balance sheet that is currently still partially discounted.

- Detrex (DTRX)

This specialty chemicals company settled an environmental lawsuit which spurred higher price. This was in line with the comments that I added next to the stock in the watchlist. While DTRX continues to trade at a significant premium, the operations and dividends might be worth knowing about.

- Dyadic International (DYAI)

While this stock is likely to depend on what is going to happen with its cash which almost matches the current market cap, some believe that the operations are also valuable. I have not dug more into the company given the product is biotech, but the report could be a good start.

- Evans & Sutherland Computer Corp. (ESCC)

I have quickly mentioned this computer graphics company in the last Sunday update as I have noticed a positive commentary regarding backlog. I also stumbled upon the fact that Morgan Thaler, a PE and Venture Capital firm, has the company on their client list. While this might not mean much, it could be that ESCC is ready for some 'strategic alternatives'.

- Enthema Health Corp. (GRST)

This operator of various addiction treatment centers is contemplating to acquire another center. They would issue 30 million shares as a payment. While this might increase the operations, the 8-K also mentions that the center would need to re-negotiate certain liabilities and thus it might be burdened by debt.

- Cadus Corp. (KDUS)

Cadus is another case of an acquisition, third one for the watchlist. The majority shareholder offered to buy out the rest of the shareholders for $1.3 per share. While the offer still needs to be approved, I have talked to one KDUS shareholder and he is not contesting the price, thus it might be likely that the upside of 38% (since addition to the watchlist) might be a lock.

- Homasote (HMTC)

This manufacturer of wooden fibreboards has jumped after they released the annual report from 2016 and the result of first six months of 2017. The operations seem to indicate that the company could survive as they stabilized the cash flow which then paid off the debt. Given the negative equity though the thesis still seems to be quite speculative. That being said because the results are clearly the catalyst now, further upside might be visible (although they are not consistent regarding posting financial results).

- Inventrust Properties (IARE)

This REIT has announced a tender offer for shares at $1.55 per share. Given the lack of liquidity in the stock this tender is unlikely to offer an arbitrage opportunity. If they actually are able to buy most of the shares, this is only going to make matters worse. This might then offset the attractive valuation from tangible book point of view.

- Itex Corp. (ITEX)

This alternative cash platform recently released their annual report which I labeled as neutral as it does not change much in terms of the potential investment thesis. Their cash flow is quite solid even if the revenue is stagnating and the dividends and repurchases are positive, but the premium to tangible book slightly offsets these points. The catalyst is also unclear if the results did not move the share price.

- Alaska Power & Telephone Co. (APTL)

There was little reaction to the recent results of this Alaskan telecom. This might not be entirely reasonable as the cash flow continues to be strong, they issue a dividend and the entire business is likely protected by their current position in the market. The balance sheet also provides a certain margin of safety.

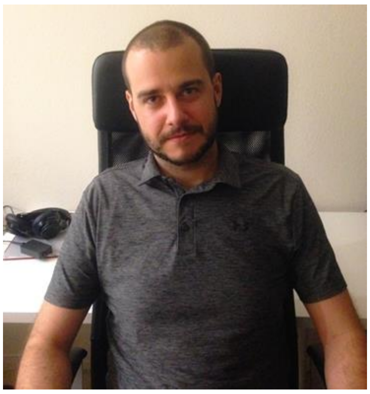
Financial Disclosure: I do not own shares in the aforementioned companies at publication date.

Interviews

Interview: Geoff Gannon

STOCK PICKING DISCIPLINE

Dear members,



I am happy to share another interview with you. This time with a seasoned investor and long-time investment writer Geoff Gannon. Geoff has been focused on value investing for the past 20 years. In that time he wrote for different outlets as well as his own newsletters and his blog. In that time, he frequently ventured into the OTC land and most of the time focused on small-caps.

I hope you will enjoy the discussion and if you have any questions that you feel were unanswered do let me know and I can send them to Geoff.

As a start, could you please share with us why you kept your focus on small/nano-caps for more than 13 years?

The main way I value a business is to imagine what the business will look like 5 years from now and then imagine what a private buyer would pay for 100% of that business. In normal times: I find more stocks among microcaps that meet this "private buyer" test than among big stocks. For example, I've found a decent business selling for less than net cash among stocks with market caps below $50 million but never above $1 billion.

I have bought big stocks, but almost always during a special situation, an industry downturn, or a stock market panic.

I don't really care about a stock's market cap, whether it is or isn't a special situation, etc. All I need is a stock where I think I can see 5 years into the future and know the stock's cheap today versus that future.

How would you describe your investment strategy and what are the most important factors in it?

I need two things. One, a business I can have confidence in. And two, a low hurdle for that business to clear. Price is the hurdle it has to clear. I always go in thinking I'll own a stock for a minimum of 5 years even though I often sell before then. And then I never want to buy anything where I don't think my return is going to be at least 10% a year. I don't think a lot about upside beyond that. I really just ask: "which stock is the one I'm most confident will manage to return 10% a year even if I was forced to hold it for the next 5 years."

Generally, this is a business with what I call "market power". It doesn't face a lot of price competition. Maybe it has a high customer retention rate. Maybe it dominates a niche. Warren Buffett would call what I'm looking for a "moat". So, the two factors I care most about are: 1) The business faces lower than normal competition and 2) I'm paying a lower than normal price for the business.

How do you form your 5-year 'future' outlook?

I don't project out macro things. I just expect them to be at their long-term trend and that it will take the full 5 years to get back to normal. So, for something like a bank my assumption when the Fed Funds Rate was at 0.25% was that it would be at 3% in five years. A 3% Fed Funds Rate is at the low end of the historical norm. If you are in the middle of a bust in a cyclical industry right now, you'll probably be pretty close to a boom in 5 years. Frost (CFR) makes energy loans. So, when I bought Frost, there was some concern as oil was at like $30 a barrel.

I assumed it'd be at $50 a barrel in 5 years. It got to $50 a barrel a lot faster. Actually, Frost is a good example of that because people were worried about two things – a very low Fed Funds Rate and a very low price per barrel of oil – that were both very out of line with the long-term historical trend and so were likely to correct over time.

I never assume any macro variable will get to normal faster than in 5 years, but I always assume it'll get back to normal. I don't take the risk that the price of oil will never rise, or the Fed Funds Rate will never rise seriously. When you're looking out 5 years, today's level isn't important. The average level of the last 50 to 100 years is what matters.

I do project out company-specific things. So, in the case of Frost I'd project out that the bank would have maybe 33% more deposits in 5 years (about 5% to 6% annual deposit growth). With Tandy Leather (TLF), I'd try to imagine how many new stores they might open per year. In fact, I passed on that stock personally when I realized they weren't having any success opening new stores. Without store growth, it's a less interesting stock.

But, the question I ask is: "What will store count be in 5 years?" I don't really project out changes in the margins of anything. I try to focus on businesses and industries where margins don't move much. So, for BWX Technologies (BWXT), I'd use the Navy's plan for taking carrier and submarine deliveries. For Omnicom (OMCM), I'd assume ad spending grows at least in line with inflation and maybe as fast as nominal GDP. I don't go any deeper than that usually.

Do you have projections that you repeat every time no matter which stock you are looking at?

No. Each case is unique.

How do you think about a stock that is trading above tangible book and how do you treat the implied future cash flow expectations? Do you quantify cash flow in any way?

Well, if a stock is trading above tangible book value it would need to have better returns on its tangible equity than the return you can expect in the stock market. So, let's say long-term stocks return maybe 8% to 10% on their market price – that means, you don't want to buy a stock at above book value unless you think it will return 11% a year on that book value.

How do you analyse a management team?

I don't talk to management. I read earnings call transcripts, interviews, etc. I can think of cases where I didn't invest in a stock because of management. But, I can't think of any cases where I did invest because of management. It's not a topic I think much about.

Catalyst or valuation? Which one do you think is more important when it comes to an investment?

Valuation. I did once inadvertently buy a microcap with a catalyst. I started buying the stock around $5 a share only for the CEO to make an offer to take the company private at $6 a share. Some people were willing to sell out at an average of around $5.80 instead of holding till the deal went through. So, I bought up literally all the stock I could at that price. I wrote a couple letters to the board. The deal was eventually done at $8.50 a share. I'm sure I had nothing to do with the higher price. What got the board to that higher price was a low starting valuation. The initial going private offer was made at a price-to-book of 0.7 and a P/E of 6. That value was the real catalyst.

Who influenced your investing strategy the most and what is your favourite book that left a significant 'mark' on you?

My favorite book is Joel Greenblatt's "You Can Be a Stock Market Genius".

I've certainly read as much as I could about Warren Buffett's career from the 1950s through the 1970s and Ben Graham's investments too. I have a copy of Graham's memoirs. I've tracked down contemporary newspaper articles discussing stocks he invested in. I have old Moody's Manuals from Graham's days and Buffett's early days. But, I can't really say I'm sure they've influenced my investing strategy.

I started investing around age 14 before I ever heard of value investing. And I thought mostly in the same terms I do today: what's a business I can understand, what will it look like in 5 years, is the price today cheap enough that I'm sure I can make 10% a year over those 5 years. So, I'd say I'm interested in Buffett and Graham, but I'm unsure how much of an influence I can trace back to them.

Did statistical investing ever appeal to you? Or were you always pure stock picker?

No. Statistical investing never appealed to me. I do screen for net-nets. I've done backtests myself and I know that a pure microcap net-net strategy with just a minimum quality requirement (like you only buy stocks that have been profitable for a long time) would at least match my stock picking. There are mechanical strategies that could do 15% to 20% a year over the last 20 years. And, remember, the last 20 years were bad ones for the S&P 500. Basically, it's a net-net strategy. That's the one that works best nearly all the time in nearly all the world.

When I invested in Japan, I did it in a way I'd consider just statistical investing. I just said I'd buy every stock I came across that was trading for less than its net cash and had 10 straight years of profits. If a stock met those two criteria, I bought it. Once I had 40% to 50% of my portfolio in 5 of them, I stopped. But, I never did any actual stock picking in Japan. And my Japanese net-nets worked out better than any other strategy I've ever used. Net-net investing works great. If investors want to do that without layering any human judgment on top of it, that's fine.

There's no way the S&P 500 is ever going to beat net-nets over a long stretch of years. So, net-net investing is a simple, statistical approach that ensures you'll beat the market. Not every year. It hasn't been good relative to the market for about the last 5 years. And it's maybe close to a wash versus the S&P 500 since this bull market started. But that's about as bad as it ever gets – you match the market in a long bull market. Not much of a risk. If you pretend the market doesn't exist and just do net-net investing for your whole career, you'll get a good result. So, I don't really see the point in any other kind of statistical investing. If you're not going to pick your own stocks, you should just buy net-nets.

If you had a book deal, what would the book be about?

The book would just be case studies. It would just be the story of an investment in a stock, what it looked like before I bought in, what it looked like when I sold it. So, you wouldn't talk about the idea of low price-to-book stocks, you write a chapter illustrating the purchase of a low price-to-book stock like the story of Bancinsurance I told where the majority owner and CEO wanted to take the company private and yet investors still made 40% more than his original offer in less than a year.

Instead of having a chapter about stock buybacks, you'd just analyse Warren Buffett's investment in the Washington Post compared to other media companies of the time that did more acquisitions and fewer buybacks. The book would be all practical stuff, no theoretical stuff.

I'm always telling new investors to stop reading value investing books and start reading 10-Ks.

Is there any surprising source that you learned something about investing from?

Well, I invested in Village Supermarket when I was a teenager, because I worked at the company as a cashier. That's also why I invested in Coinstar. So, I got two good stock ideas from one summer job in high school. I made several times more money from those stock ideas than from my paychecks. It sounds silly to say that a high school job gives you the knowledge you need to invest. But, as a cashier I had knowledge about customer behaviour regarding Coinstar that investors lacked.

It was obvious to me that people who used Coinstar machines saw that Coinstar receipt as found money, they would still use it if the commission was higher, and that having a Coinstar machine was a plus for the store too. As far as living near Village stores and working in one, I knew you couldn't open competing stores near them. Every investor comment I read in the late 1990s about Village mentioned the threat of Wal-Mart, Whole Foods, and online groceries.

I could see online groceries wouldn't take off at all. I could also see there was literally no place to site a large competing store nearby. You couldn't build a big enough parking lot. At peak times, the store I was working in had cars "circling" waiting for a spot to open.

On paper, investors assume it's always possible for competition to enter a market. They don't realize that without the ability to build a large parking lot, no supermarket can enter the local market.

What is the one thing you feel many value investors are missing out when investing or researching?

They don't think of the stock as a business. They know they're supposed to. But, they really don't. They think of the stock as a stock. So, they don't use logic, common sense, etc. the way they would if looking at a local business they wanted to buy in its entirety. The question I always try to get people to answer is – let's say you're looking at a $30 million market cap company, "If you had control of a $100 million family fortune, would you put 30% of that into owning all of this business".

Like, I mentioned Village and Coinstar. I would have absolutely answered yes to that question. If all of Coinstar was for sale, I'd buy it. If all of Village was for sale, I'd buy it. Investors think a lot about everything else and not enough about that one thing that really matters. Basically, if a public company would work as something you'd buy all of – it'll work as a stock. You just have to have faith it'll somehow work as a stock.

The reverse – thinking that a business you wouldn't buy 100% of at today's price will work as a stock despite that – makes no sense. But, because of sort of statistical thinking about what value investing is and also focusing on the catalyst and things like that people drift into doing something other than just imagining the board is offering them 100% of this public company at today's market cap. That's always the fantasy you should be playing out in your head.

On your Focused Compounding profile you list Activision as one of your best investments, what made it so? What were the main learning points?

Well, I mentioned Activision because it's an example of how by doing a lot I got a worse result than if I'd done nothing. In 2001, I owned just one stock: Activision and I had a pile of cash. I would have been 16 at the time. Right after the markets opened following the September 11th attacks, I put all my cash in Activision. So, I had 100% of my net worth in one stock. Well, that one stock went on to compound at like 20% a year for the last 16-17 years now. Instead of holding on to Activision for all those years, I bought a lot of stocks and sold a lot of stocks. I did fine. But, it was more work for less of a return. The main learning is something I say to people all the time.

The best way for you to invest is probably to spend all year thinking about which stock to buy. Then, you should buy just that one stock. And then you should just forget you own it. So, in 2001 you buy Activision. In 2002, you buy a different stock with the money you save in 2002. But, it's not really worth it to second-guess your original purchase and decide which stock to sell now to make room for your new idea. Always focus on coming up with another great idea. Think only about buying the right stock at the right price. Don't think about selling at all.

How did you invest during the financial crisis?

I sold everything I owned and bought the highest quality companies I could find. So, I loaded up on companies like Omnicom and IMS Health. I also bought Berkshire Hathaway for the first and almost certainly last time in my life.

Why certainly the last?

Like I said, I'll buy a stock when it's trading at less than two-thirds of my appraisal value. Berkshire is not a stock that's likely to do that in the future. Generally, stocks that are big and liquid and well-known aren't stocks that trade at big discounts to what they're clearly worth. So, I'd be amazed if I ever bought Berkshire Hathaway stock again. It's just unlikely to ever be cheap enough to interest me.

What is your experience with the OTC stocks? Do you have (or had) any favourite OTC stocks?

Well, I mentioned two already. George Risk (RSKIA) was the "decent business selling for less than net cash" I bought in 2010 and sold in 2017. I owned it for about 6 and a half years. It didn't beat the S&P 500 during that time. So, you could call it a failure. But, it worked out exactly as I expected – I just didn't expect the market to go up so much too. I bought it below net cash. The company's after-tax return on its non-cash (that is, invested) capital was probably 30% a year normally. It doesn't grow. But, it's extremely high quality for a net-net.

Bancinsurance was a stock I knew back when it was listed and then it had a scandal, got dropped by its auditor, de-listed, etc. So, it was an OTC stock when I actually bought it. I put over 20% of my portfolio in George Risk while I owned that. I had more than 40% of my portfolio in Bancinsurance.

You mentioned catalysts. I can think of a few OTC stocks with catalysts. But, depending on when this interview is released, one or both of these may be out of date. The two that come to mind right now are Keweenaw Land Association (KEWL) where Jamie Mai of Cornwall Capital is trying to win 3 board seats thus giving him a majority of the board. It's a timber company that recently announced it has about 25% more actual timber on its land then its models predicted. There's also a chance someone starts building a mine on their land this year. The catalysts is a proxy battle that will be decided on April 12th I think.

The other catalyst situation that comes to mind is a now dark stock called Pendrell (PCOA). The CEO is Lee Mikles who ran FutureFuel which was like a blank check company that acquired a chemical business. Here, he'll have to do the same thing: acquire something. Pendrell has cash. The stock is trading at about 90% of net cash. It also has patents. It was cash flow positive last year. But, the other big asset is net operating loss carry forwards. The company carries the NOLs at zero dollars (which is the correct way to do it for GAAP, but misleading in terms of what'll really happen here). They'll eventually use the cash to buy something and pay no taxes for the next 7-14 years or so.

Note by Jan: All stocks are in the database.

Did you have any losers in the OTC space?

Actually, I can't think of a single loser I've had in the OTC space. I have lost plenty of money on listed stocks. And I'm sure I've written about, talked about, etc. OTC stocks that didn't perform (I write about lots of stocks but only actually buy a very few). But, no, I can't think of any time I had an actual realized loss in an OTC stock. I may be forgetting something.

Was this tied to the nature of the OTC market or due to something else?

Stocks bounce around due to fear, greed, and boredom.

You can make a lot of money being greedy when others are fearful. But, you can make at least as much money being bored when others refuse to be bored. There are a lot of boring stocks in the OTC market. They're not cheap because people are afraid of them. They're cheap because the people who own them are tired of them always being cheap.

So, you can buy things like George Risk and OPT-Sciences (OPST) and such at net cash sometimes, because people are just tired of nothing happening with those stocks. There's no way to buy a listed stock at net cash when it's profitable. It just doesn't happen. It happens every year with OTC stocks. So, there are more sure bets among OTC stocks. And I try to focus on the surest bets I can find. OTC stocks are interesting, because even the investors I know who focus on net-nets eventually sell stocks like George Risk for no reason other than they got tired of holding it and it got a little more expensive over time.

Even I sold George Risk not out of fear but just because I had owned it for over 6 years and thought I might have another idea I liked better. I don't think you can find sure looking bets in listed stocks except during recessions, panics, down markets, etc. The prices I got on IMS Health in 2009 were as good as any prices I've gotten on an OTC stock, but it was 2009. There had been a financial panic, Obamacare was coming, etc. People were scared.

In listed stocks, you get bargains when people are scared. In OTC stocks, you get bargains when people are bored.

What was the most obscure business model that you have encountered?

A lot of the OTC stocks I've bought are niche in some way.

Bancinsurance provided coverage on "damage to pledged collateral" and also things like "skip risk". So, when a lender makes a car loan they generally want to take only two kinds of risk: 1) Will the borrower pay and 2) Will the car be worth what's left on the loan balance. They don't want to take risks like their collateral is destroyed without anyone's auto insurance covering it, the borrower takes the car to a state where it would be tough to repossess, the car is confiscated despite their lien, their lien is misfiled, etc. Bancinsurance took the risks you and I wouldn't think of.

George Risk makes burglar alarm contact switches. So, something like a pair of magnetic reeds inside a tiny hermetically sealed glass envelope. Unless the burglar creates a strong magnetic field, opening any door or window on which there's a contact switch will break the contact and set off the alarm. There are plenty of companies like that with a good position in a tiny industry.

Probably, the best example is Paradise (PARF). They make something like 90% of all candied fruit in the U.S. It's mostly used for baking fruitcakes. And for decades, the number of people baking fruitcakes has gone down. There just isn't enough demand for fruitcakes and it just isn't spread evenly around the whole year for them to make a decent return on equity. So, that's a dominant business with a low ROE.

On the other hand, you have a company like TNR Technical (TNRK) that has earned high returns on actually invested capital (so, not including the extra cash they usually carry) just putting together custom battery packs and shipping them to customers. That's a niche. The company is a sub $5 million market cap stock, but it has paid out a lot in special dividends over the decades.

OPT-Sciences has made good money making anti-glare glass for cockpit instrument panels. And Kopp Glass (KOGL) does well making technical glass for things like railways signals and traffic lights. If you're doing something that's small but important from the customer's perspective and you became a leader in doing that thing – you can usually earn a nice ROE doing it. And yet, I'd say investors haven't heard of any of the "industries" I just listed.

Note by Jan: All stocks are in the database.

Have you ever encountered a particularly bad example(s) of corporate governance in the OTC space?

I've encountered bad corporate governance in stocks of all sizes. Among very, very small OTC stocks I've seen cases where management owns about 50% of the company and then also pays themselves a salary that sometimes approaches 50% of what net income would be before their salary. In their defence, the salary wouldn't be excessive for a professional manager at a large company. But, it's big relative to the company's size and it's in addition to their ownership in the company already.

Many of the best OTC stocks are controlled companies of some kind. Controlled companies are more likely to have unusual corporate governance – unusually good or unusually bad, depending on the management – when compared to non-controlled companies.

You ran a newsletter alongside Tobias Carlisle and Quan Hoang called Singular Diligence which was aimed at producing incredibly detailed reports. What did you learn from working on this newsletter?

Writing the newsletter was the most fun I ever had doing investment writing. Each month: I just wrote about 10,000 words on some stock that Quan and I had talked about in great depth. For 30 days, I got to focus on just one stock. It was the closest I've come to doing investing writing that really just replicates what I do in my own investing.

From an investing perspective, the lesson is you can't have 12 good ideas a year. I knew that going in. I actually only bought 4 of the 26 or so stocks we wrote up for myself. And only 2 of those worked out. It just reinforced for me that you should aim for one good idea a year. That's all an investor needs.

Do you have any favourite sectors that you look at frequently?

Sure. Historically, I've liked U.S. banks.

I wrote reports on Frost (CFR), Bank of Hawaii (BOH), Prosperity (PB), BOK Financial (BOKF), and Commerce Bancshares (CBSH). On the iTunes page for my podcast, you can find an episode all about Frost. I own the stock. I've liked MRO distributors. I wrote reports on Grainger (GWW) and MSC Industrial Direct (MSM).

And I've liked ad agencies. I wrote a report on Omnicom (OMC). There's also a podcast episode dedicated to that stock. Because of the fear of disruption in the advertising industry – cutting out the middleman, in housing digital advertising, buying direct on Facebook and Google, using consultants focused on digital advertising, etc. – ad agencies stocks are super cheap right now. There's a decent amount of Omnicom stock sold short. So, a basket of the big ones from around the world: Omnicom, Interpublic, WPP, Publicis, and Dentsu would be among the absolute cheapest large-cap stocks in the world. That's the industry I'd tell people to focus on in terms of looking, and – if you can get comfortable with ad agencies' durability as businesses in a mostly mobile age – with buying.

Getting back to OTC stocks, I like "core processors" for banks. These are companies like Jack Henry (JKHY), Fiserv (FISV), and FIS (FIS). They are all listed stocks. But, a smaller peer – though still with decent market share among very small U.S. banks – is CSI or "Computer Services, Inc." (CSVI). It's an OTC stock. It tends to be a bit cheaper than the others.

If they grow earnings a little this year, pay less in taxes from now on (they had a 39% rate before the U.S. federal corporate tax cut from 35% to 21%), etc. this year we could be talking a stock with a forward P/E of 15 and zero leverage. That doesn't sound that exciting to most value investors.

But, it's a business that tends to grow EPS, dividends, etc. every year no matter what. If you look at the 20-year record, it's certainly as predictable in terms of consistent EPS growth year-after-year as any of the bigger core processors. In fact, it's actually more predictable than Fiserv and FIS. It's an OTC stock, but not a small one. The market cap is probably over $600 million or so. It might not be cheap. But, it's basically an unlisted blue-chip stock.

Also, I mentioned Keweenaw Land Association (KEWL). There are some other OTC stocks that have timberland as well as other resources. Since timberland is an asset I like, I'll always research those companies. This would include stocks like Pardee Resources (PDER). There are others.

Kewanee is unusual in that it's just a timberland business and yet it's an OTC stock. Many others combine timberland with other kinds of land or with more revenue from natural gas, coal, etc. royalties on the same land. I do own a coal company now. But, it's purely supplying mine-mouth customers. I don't think I could ever invest in a coal producer that sells at the market price for shipment by rail. But, timberland is something I can understand.

So, I'd say ad agencies, regional (especially "business") banks, MRO distributors, core processors, and timberland are all industries I like.

Do you track your favourite sectors in any other way than just via individual stocks?

No. When I research a stock, I pick the 5 closest peers I can find to it. So, I learn about other stocks in a sector because I used them as part of a comparative analysis of another stock.

What do you think of market efficiency? Do you believe it has decreased or increased over the time you have been investing?

There’s no difference in market efficiency from the time I started investing in the late 1990s until today. Prices are generally higher. And companies that would otherwise be attractive – especially small stocks – often go private.

But, that’s really an issue of competition from private equity for the stocks I like rather than competition from other minority investors. There’s no difference in market efficiency day-to-day. But there’s more competition from private equity.

Great insight Geoff, I really appreciate you taking the time to do this interview.

Financial Disclosure: I do not not own shares in any of the aforementioned companies at publication date.

Company Profiles

Company Profiles

27/06/2018

Pardee Resources (PDER)

Simplified Investment Thesis

I believe that PDER is interesting due to the following points;

- First and foremost, the company is trading below tangible book which consists of several different resources assets that are able to generate a meaningful revenue stream and free cash flow.
- The asset base is now relatively diversified. While PDER is still exposed to coal they have been able to offset the challenging times of this commodity by receiving royalties from solar, use of their agriculture land as well as O&G assets and timberland. In 2016, which saw the pressure on coal prices continue, the company was still able to remain profitable.
- Their asset base is unlikely to depreciate and thus there is a strong margin of safety here. They also redistribute a portion of the earnings via dividends (roughly 4% yield) and the management has a strong record in terms of reinvesting the cash flow they are able to bring in.

On the other hand, one has to account for the following risks;

- The revenue stream can be volatile which can impact the short-term share price. Due to the commodity nature of the asset base, the shares can underperform for a period. However, this could be offset by accepting a long-term nature of the investment thesis.

Since addition to the database (September 2017) the shares have just budged a bit higher (around 7%) which might well describe the nature of the investment. PDER might not move by 50% in a given year, but will accumulate value slowly and increase the shareholder's value via dividends. It should be beneficial to follow the company and search for the good entry points (such as 2015/16 when the shares were depressed by coal prices).

Company Description

PDER is similar to KEWL and other land resource plays. They have a number of asset plays ranging from O&G, Coal (both met and thermal), timberlands to solar and agriculture (land in California). While the assets are tied to cyclical industries and commodity prices, they have been able to diversify and weather the challenging times regarding coal. They are not operating their assets and only collect royalties. They pay consistent dividends from the proceeds.

The management track record is consistent, and I consider PDER's insiders to be close to the behaviour of listed companies. Their annual report features SP500 comparisons, they are not excessively hiding and certainly do not think about themselves as a private company that disregards minority shareholders. They are conservative but are aware of what drives the value of the company.

Current Valuation

As mentioned in the thesis, the company trades at discount to tangible book. The book mainly consists of their resource assets. One could do a sum-of-the-parts valuation which would likely show a strong upside due to their land holdings.

They own over 170,000 acres of timberland which on its own commands a large portion of their value. Their appraisal from a few years ago came at $1,000 per acre. The value of the land could then be higher than their entire current market capitalization. They also own land in California which they lease for agricultural purposes (mainly grapes).

The second biggest asset is likely to be their coal royalties which due to the rebound in met coal will provide further revenues. Their solar holdings likely to be the third biggest asset which is providing the company with stable revenue due to long-term fixed contracts. The management also mentioned that they might be interested in participating in the battery storage space in addition to solar. Their O&G assets are also valuable as they have exposure to natgas through various assets in both shale gas and coal bed methane.

Safety in Value did a [SOTP valuation in 2017](#) and came up with $252 per share as possible value or 30% upside from the current prices.

Finally, I would mention that they are unlevered. They use debt from time to time to finance expansion, but always maintain only a sensible amount of it. In 2017 they paid most of the outstanding liabilities.

Catalyst

While the nature of the company is based on their long-term revenue streams, there could be a catalyst here due to the rebound in met coal prices which still seems to hold. One can see the positive impact of this in their 2017 annual report. The revenue from coal was higher by $5 million, almost all of which flowed through to the bottom line as they are not operating the assets. They could record similar results this year.

I would also mention that the dividend yield is likely to offset the lack of other catalysts that would unlock the value of the company's balance sheet. It is worth pointing out that the company did several tender offers in the past which could help to redistribute the value as well.

Capitalization

The company does not have any other class of stocks than its common stock. Their options outstanding are immaterial.

As a final note, I am in the possession of presentation slides that were presented during an annual meeting. I also have the comments of the company's management during this meeting. If you wish to see them, just reach out to me.

Boss Holdings (BSHI)

Simplified Investment Thesis

I have written about BSHI for the first time on [Seeking Alpha](#) where I showcased the following thesis;

I believe that BSHI is offering an investment opportunity due to the following points:

- The operations are stable and keep on producing free cash flow alongside positive margins. The company has not seen a single loss since 1995, and even during the crisis, the revenue did not drop significantly and each of the segments were profitable. This then allows the company to continuously produce shareholder value. The company generated $7 million of cash in past 10 years and currently holds $14 million on its balance sheet with a market cap of $26 million. This ability is unlikely to change due to the nature of its products and markets in which BSHI operates.
- The valuation is still enticing even despite the run-up in the share price in the past 5 years. The NCAV value is still roughly 40% above the market cap, and while one could argue that the inventories might need to be discounted, the company is likely to carry over depreciated real estate on its books which could partially offset this.

On the other hand, these following risks need to be accounted for:

- The thesis has an unclear catalyst for unlocking the value in the company as the management might not be incentivized to reward all shareholders the same. The current CEO and Chairman, Mr. Graziadio, owns at least 50% of the company alongside a group of closely connected insiders who own further 7.7%. This gives the group the ability to significantly influence the business. While he and the board are unlikely to mismanage BSHI, they might not want to sell the company or distribute the cash that recently built up on the balance sheet. The company does have a buyback program in place, but I believe this is mainly to further increase the ownership and not necessarily to buy shares on discount.
- There is not much operational upside. While the company has been able to maintain solid profitability over the years, the revenue is unlikely to grow substantially, and thus, the value of the company is unlikely to increase much (apart from consistent cash flow). They could try to do an acquisition to spur some growth, but due to the low level of M&A in past, the management might be reluctant to do so.

Despite these, I believe that BSHI presents a clear investment opportunity, but due to the relative illiquidity and the lack of catalyst, I believe investors are better off with initiating only a statistical position as the appreciation of the shares is likely to occur in the long-run rather than in the near future.

I believe that the thesis remains the same and the stock is likely showing an investment opportunity. The article about BSHI is from early 2017, but not much has changed. The share price has risen by roughly 20%, but they are still operating profitable operations while the stock trades at a similar discount to liquid tangible book which creates a margin of safety. While the catalyst is also still unclear, I do not believe this completely offsets the potential upside.

Company Description

BSHI is a holding company that operates four separate businesses. The biggest in terms of revenue is the focus on gloves and protective wear which were also the initial products that BSHI started to manufacture in the late 19th century in Kewanee, Illinois.

The other segments are pet products, specialty advertisements products (Galaxy Balloons) and phone accessories (Aries Manufacturing). These have been added and expanded throughout the past 15 years via small acquisitions. Most recently they acquired a pet product company in May of 2018.

Current Valuation

As mentioned in the thesis the company is currently trading at a material discount to tangible book which is liquid due to their cash position. They do have sizeable inventory levels, however due to BSHI's ability to generate free cash flow I am not worried that they would not be able to decrease it.

I would also note that their PP&E is likely over depreciated. They own three buildings in Illinois which act as their distribution centres. They alone could be worth around $6 million (ultra-conservative estimate at $25 per SF). This would add substantial value to the balance sheet as their PP&E is around $2 million. This acts as a further margin of safety.

Catalyst

I believe that one thing that would alter the valuation would be the utilization of their cash position. They have done two deals in the pet products space which did not really move the needle, a larger acquisition could make the difference. I believe that the management team (revolves around Mr. Paul A. Novelly) could be efficient in terms of capital allocation as per their previous experience.

Other than that, the stock is likely to move slowly but surely higher as result of BSHI's ability to create surplus cash and thus increase their tangible book.

There is always the possibility of the insiders taking the company private (possibly at a low-ball price), however the management is not overly active when it comes to the reduction of shares outstanding.

Capitalization

The company does not have any other class of stocks than its common stock. Their options outstanding are immaterial.

Financial Disclosure: I do not own any shares in any of the mentioned companies.

How to argue about OTC at parties

Tired of listening to your brother-in-law from a bulge bracket investment bank rant about how OTC is ridiculous or how anyone who holds 'penny stocks' is not a serious investor?

Well then, I present you with a set of arguments you can use to show that OTC market is an investable market.

- Argument #1 – Ignore him or support his view that OTC is uninvestable

The number one thing OTC investors do is that they do not talk about OTC.

This sort of Fight Club mentality (the first rule of fight club is that you do not talk about it) preserves the investment opportunities in the market. It as simple as that. The less people will understand the market, the more opportunities for the existing community.

Let him throw whatever arguments at you. Be patient and ignore him or even pat him on the back and tell him that you will transfer all of your VULC stock into his new inverse VIX ETN that will certainly not blow up this time.

- Argument #2 – Reputation of the OTC market is irrelevant

If you had enough and/or need someone to partner with to dislodge a low-balling management at an OTC company, then you can start with reputation.

In your OTC discussion with him, he will surely mention Wolf of Wall Street at least once. Either he will accuse you of being another Jordan Belfort (without a biopic directed by Scorsese) or he will say that you will probably run afoul to such stock pusher.

It is a fair, yet naïve, view. Pump and dumps are still present in the OTC market. However, the nature of these frauds is simple and even basic due diligence will uncover most of these fraudulent stocks.

One can look at recent cryptocurrency pump and dump schemes which were uncovered just by looking at the balance sheet of the company and comparing it to market capitalization.

One example for all can be Crypto Company (CRCW) which was at one point valued at $1 billion while having a tangible book of just $3.5 million. Makes sense. Is it the next elaborate scheme to concoct an Enron-like fraud? Hardly.

Most importantly, generalizing the pump and dump bias to every stock in the OTC is simply wrong and can be easily exposed as flawed logic. Sure, most OTC stocks might be crapshoots, but a meaningful amount of them are not.

While this reasoning is easy to follow, I would like to stress that due diligence in the OTC world is really everything and one needs to perform it carefully and patiently.

- Argument #3 – Obscurity is irrelevant as well

Your brother-in-law might become a bit more intrigued now. He might even pull up OTCmarkets.com (i.e. homepage of every OTC investor) and start searching for a stock. But all he sees, are these obscure companies that do not make much sense.

Who on earth would want to own a share of company solely producing candied fruit (PARF), or a unit of a trust tied to bunch of songs from the 1930's and 1940's (MMTRS)?

He usually does not answer himself and thus he returns to tweet about the latest earnings of $SNAP, a camera company.

However, it turns out that patient enterprising investors who perform detailed due diligence would want to own shares of these companies. It might take a special type of research to be able to get to the bottom of the stock's value, but obscurity on its own is not a challenge or an obstacle.

- Argument #4 – Data can be found and are reliable

Now your brother-in-law might actually try to get a balance sheet or income statement of some OTC companies. A lot of times this means that he will need to venture out of Edgar and find financial information on corporate websites, stock blogs or even the eccentric Investors Hub.

Sometimes he will not able to find anything (literally anything as was the case with ATCD for example) and will need to buy a share and then get the information.

Because of the way he was able to find the information he will start to doubt the validity and reliability.

However, over 98% of meaningful companies have audited results. Thus, there is similar accountability as for companies that are listed and are regulated by the SEC. Do not forget that a good portion of meaningful OTC stocks still file with the SEC (about 50% in this manual).

Couple that with proper due diligence and you can vastly minimize the risk of being exposed to a fraud that would obfuscate their results, like say a large pharmaceutical company that had some unfortunate ties to one pharmacy.

Lastly, one should also think about two things.

Why do some OTC companies want to remain hidden? Most likely because there is some value, not because they are a fraud.

Would an elaborate fraud make sense in the OTC land? Not really. For that you need visibility in order to push the shares up and meaningful volume to be able to sell these shares. The listed market is much more suitable for that.

- Argument #5 – Corporate Governance is not insurmountable issue

The first moment where you will not be able to brush your brother-in-law with a concrete answer is the question of corporate governance. He might accept the financials at face value.

However, he might say that the companies are controlled by single shareholders and sometimes misuse this control to benefit themselves.

This is a fair point, governance in the OTC space can be abysmal in some cases. Just look at Waxman (WXMN), insiders of which tried to buy out the company at 12% of book value.

The key point here is that you can always sue the insiders. You can appraise your rights or try to nudge the management through a fiduciary duty lawsuit. Now, this might seem daunting or even impossible for some people. However, activism is relatively alive in the OTC land and many times a collective effort can work. In the end, Waxman did not buy out the company.

Lastly, one can again minimize this risk through proper diligence and proper adjustment of liquidity expectations (am I okay with holding this amount in this company for three years if no catalyst materializes?).

This argument also shows why I am not using the words enterprising investor randomly. Investing in OTC can a lot of time can really be an enterprise.

- Argument #6 – Volume & Liquidity is present

Your brother-in-law might now say that even if he were to accept the corporate governance situation, he can barely buy anything! Everything is illiquid and there is not enough volume.

This point holds for people that have more than $10 million in their portfolio. Once you are large you simply can't enter the market because you would move every stock you would want to own or you would have to wait ages to build a meaningful stake.

For people that own less than $10 million I present the following table which looks at the long ideas presented in my newsletter (which you can find in the second PDF of the manual).

Ticker	Initiating Report	Share Performance	Volume Since Report
A17	Oct-17	206.67%	>$50,000
A33	Jul-18	98.36%	>$0.1 million
A15	Mar-18	78.57%	>$1 million
A11	Sep-18	66.39%	>$0
GANS:US	Sep-17	65.63%	>$1 million
A5	Dec-17	53.92%	>$1 million
A36	Nov-17	53.85%	>$1 million
A4	Sep-17	47.28%	>$1 million
A28	Aug-17	34.53%	>$1 million
A42	Sep-17	29.73%	>$0.5 million
A26	May-18	21.70%	>$0.1 million
A48	Dec-17	21.60%	>$0.1 million
A12	Aug-18	20.54%	>$0
SORT:US	Nov-17	20.00%	>$50,000
A32	Apr-18	19.70%	>$0.1 million
A27	Feb-18	17.65%	>$0
CAGU:US	May-18	16.67%	>$0.1 million
VULC:US	Jun-18	14.78%	>$1 million
A35	Sep-17	14.29%	>$0.5 million
A41	Sep-17	13.32%	>$1 million
A50	Nov-17	12.66%	>$0
A18	Aug-18	12.50%	>$0
A39	Aug-17	11.26%	>$1 million
A3	Aug-17	5.26%	>$0.5 million
A19	Apr-18	5.15%	>$0.5 million
A46	Mar-18	4.68%	>$0.5 million
A16	Jul-18	4.23%	>$0.1 million
A30	Oct-18	3.13%	>$0
A24	Jul-18	1.49%	>$0.1 million
A21	Mar-18	1.20%	>$1 million
A44	Oct-18	0.49%	>$1 million
A49	Oct-18	-3.16%	>$50,000
A10	Dec-17	-3.18%	>$0.1 million
A13	Sep-18	-3.33%	>$0.1 million
A31	Sep-18	-4.63%	>$50,000
A9	Mar-18	-4.94%	>$1 million
IBAL:US	May-18	-5.00%	>$0.1 million
A40	Feb-18	-5.21%	>$1 million
A22	Jan-18	-8.10%	>$0.1 million
A43	Apr-18	-11.06%	>$1 million
CZBS:US	May-18	-11.47%	>$0.5 million
A20	Jan-18	-14.00%	>$50,000
A25	Apr-18	-14.43%	>$1 million
A34	Feb-18	-16.67%	>$0.5 million
A7	Sep-18	-16.67%	>$0
A2	Oct-17	-16.67%	>$0.1 million
A45	Aug-18	-20.51%	>$0.1 million
A29	Jan-18	-22.73%	>$0.1 million
A6	Oct-17	-23.08%	>$1 million
A14	Mar-18	-23.34%	>$0.1 million
A38	Jul-18	-26.67%	>$0.1 million
A23	Aug-17	-34.16%	>$1 million
A47	Sep-17	-36.59%	>$0.1 million
AAIIQ:US	Feb-18	-50.63%	>$0
BDVB:US	Sep-17	-90.67%	>$0.1 million
PRXIQ:US	Dec-17	-97.68%	>$1 million

In this table you can see that while some situations were certainly limited to smaller portfolios of below $1 million due to the volume being just around $0.1 million, six of them had volume bigger than $1 million.

The summary table confirms the idea of investable ideas.

Volume	# of Stocks
>$1 million	18
>$0.5 million	7
>$0.1 million	18
>$50,000	5
>$0	8

- Argument #7 – Academic Papers are Misleading

If for some reason your brother-in-law has a penchant for reading academic papers about the stock market, he could pull one more argument and point to papers such as 'Outcomes of OTC investing' by the SEC or 'Asset Pricing in the Dark'. These point to the absolute underperformance of the stocks in the OTC market and point out that generally you stand to lose money.

These studies are objectively correct. If you look at the whole market, it is no wonder that you would lose money because you are going to include the classic pump and dumps or meaningless stocks which weigh down the fundamentally sound businesses which are in a minority.

However, no one in their right mind would try to invest in the whole OTC market. Just the existence of this manual and its predecessors point to the fact that you need to carefully choose a minority of stocks that you want to look at. I highlight 351 stocks in this manual while the OTC market counts roughly 7,000 or 8,000 US-based stocks.

By doing this selection you are applying your own subjective view about whether the stock is meaningful or meaningless. Academic papers are unable to do that, because they would have to try to define meaningless companies or try to have a system to identify pump and dumps.

Thus, all they can do is be objective in a market where no one is. A classic problem of academia.

If your brother-in-law actually made it all the way here, by now he should be only able to say that his portfolio is either too large or his preference for liquidity does not match the OTC standard. That is it. These arguments are completely acceptable, but these are personal arguments.

I am not saying that anyone who has below $10 million should invest in the market.

There are many unique risks that one has to properly understand, but this is again tied to personal capabilities (**prior experience**, due diligence ability etc.) and circumstances (liquidity, portfolio etc.).

Index of Stocks Highlighted

Here you can find a simple index of all tickers mentioned in the manual in an alphabetical order.