SMALL STOCKS, BIG MONEY

Interviews with **Microcap Superstars**

DAVE GENTRY

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Small Stocks, Big Money

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Praise for *Small Stocks, Big Money*

"If you want a focused read on how to get rich buying smaller-cap stocks, this is the book. Mr. Gentry is at the top of his game. He writes with ease and grace as he describes how the big men got rich in microcaps."

—*Ray Akers, executive chairman, Akers BioSciences, NASDAQ: AKER*

"*Small Stocks, Big Money* is a fascinating read. It gives a solid account of the psyche, discipline, and the value systems of some of today's most successful microcap investors. This book is a must-read for both investors and entrepreneurs who are developing or investing in growth companies."

—*Dhru Desai, executive chairman, Quadrant 4 Systems*

"*Small Stocks, Big Money* is the comprehensive guide to navigating the sporty world of smaller-cap investing. You'll enjoy learning about how men like Byron Roth built an investment banking powerhouse in Southern California finding small companies that later became dominant players in their space."

—*Dan Erdberg, chief operating officer, Drone Aviation Corp.*

"Gentry has delivered what has never been done until now, providing a detailed picture of the microcap landscape with all its twists and turns, winners and losers. This is a book long overdue. *Small Stocks, Big Money* is chock full of wisdom from some of the best players in the business. It belongs on the desk of every investor who wants to learn from the pros how to make money investing in microcap stocks."

—*Paul Burgess, CEO and president, Lattice, Inc.*

"*Small Stocks, Big Money* should be mandatory reading for anyone studying business or finance. As a long-time owner of a small-cap investment bank, I was pleased to discover a book that provides a sweeping history of the microcap space. This is a book that every stock broker and every banker in the country could benefit from reading."

—Richard Rappaport, founder and CEO, WestPark Capital

"Dave Gentry is a rare find in the microcap space. As the CEO of a public company, I found *Small Stocks, Big Money* an incredibly helpful guide. If you want to know how to make it in this space, this is your book. It's a great read for novices and professionals."

—George C. Carpenter IV, CEO and president, CNS Response, Inc.

"Dave Gentry has my respect and admiration. As a CEO new to the microcap space, I am quite pleased to know that I am working with a team that knows the ins and outs of smaller-cap stocks. *Small Stocks, Big Money* is a sizzling look at those who dominate this volatile world. It's a fascinating read."

—Andrew Durgee, CEO, The Cointree

"*Small Stocks, Big Money* is a unique and privileged look at the ultra-rich in microcaps. This book is a great read on two counts: lots of practical business advice, and it serves as a basic tutorial on how to make millions buying small growth stocks."

—John Lorenz, CEO, Global Recycling Technologies

"*Small Stocks, Big Money* is a study in how the biggest players in the microcap space became rich but it also provides a historical context for both the Superstars and the companies they invested in, which make the book even more interesting."

—Richard Kreger, senior managing director of investment banking, Source Capital Group

Quotes from the Experts

"The single most important way we attempt to manage risk, in any environment, is by seeking to buy stocks very cheaply—we never want to pay too much."

—*Bill Hench, portfolio manager, Royce Opportunity Funds, Microcap Superstar*

"Small caps outperform not because of market capitalization alone but because the stocks in this category are least efficiently priced."

—*James O'Shaughnessy, author of* What Works on Wall Street

"Higher returns, of course, come with more risk . . . the trade-off is, yes, you get long-term outperformance . . . but the volatility of returns is greater. . . . That's the price you pay if you want exposure to a better-performing asset class."

—*Samuel Dedio, manager of the Artio U.S. Microcap Fund (JMCAX)*

"The hardest part of raising capital for CPI was that we were totally unknown. I was a young Puerto Rican kid in Minneapolis, a land of Midwesterners. I had no previous history in manufacturing or inventing anything. Imagine you go to an investor and say, 'We're going to make a better pacemaker,' and they say, 'Doesn't Medtronic make a pacemaker?'"

—*Manny Villafana, founder of St. Jude Medical, Inc., Microcap Superstar*

"The risk always lies within management, so we're constantly evaluating through our three-part process. We meet with three to five CEOs and CFOs of small companies in our offices every week."

—*Michael Corbett, manager, Perritt Capital Management, Microcap Superstar*

"We've found that the area that we can perform the best is in the microcap space. So it's a microcap value bent that really differentiates us, and that is because it's an area of the market where there are enormous inefficiencies and where our hard work pays off, because we can identify opportunities that are significantly underpriced."

—Eric Kuby, chief investment officer,
North Star Investment Management

"Investing in small- and microcap stocks requires significant time and resources because few investors are focused on the space. The reason that many investors do not pay attention to this space is that as managers' assets grow, it becomes increasingly difficult and cumbersome to allocate capital to less liquid and under-researched companies. With a higher level of assets under management, the contour of their portfolio, at some point, needs to change: either more names need to be included in the portfolio, diluting the impact of any single idea, or larger companies need to be included, forcing the portfolio to drift into a more efficiently priced universe."

Punch & Associates Investment Management, Inc.

"Be patient when buying. It might take six months to accumulate a position; you should be in for the long term and remember 20% of microcaps go to 0."

—Buzz Heidkte, chairman, Midsouth Investors,
Microcap Superstar

"Work hard, be a long-term thinker, develop tenacity and remember nothing happens without taking calculated risks."

—Phil Sassower, chairman, Phoenix Group, Microcap Superstar

"For me, the fun is to build, not to manage. I look for what's available, what is possible to do. That's the overriding consideration. There are a lot of things I would have liked to do, but didn't have the means."

—Dr. Phil Frost, chairman, OPKO Health, Microcap Superstar

"I've made my money by being the first in markets. As a venture capitalist, you have to seek out the cutting-edge companies. You get in as early as possible. That way you make a lot more headway and profits."

—John Pappajohn, entrepreneur, philanthropist, business leader,
Microcap Superstar

"Do your homework—understand companies you invest in forwards and backwards."

—*Charles Diker, Diker Management, Microcap Superstar*

"Investment advisors generally steer clients away from small stocks because they can be volatile and offer lower returns on average than their larger, more stable counterparts. Microcaps, then, are usually viewed as a trade to take advantage of momentary price movements, rather than as a long-term investment."

—*Jeff Cox, finance editor, CNBC*

"I had grown tired of backing make-believe CEOs and entrepreneurs, so my partners and I went on the board, took a hands-on approach, built the company, and put in a solid management team" (Interclick, sold to Yahoo! for $270 million).

—*Barry Honig, founder, GRQ Consultants, Microcap Superstar*

"Invest in something you can get your arms around and be very conservative, own enough stock so that you are not putting all your eggs in one basket."

—*Dave Maley, fund manager, Ariel Microcap Funds,*
Microcap Superstar

"If you want to invest in the microcap space, buy companies, not stocks; if you buy stocks, the daily fluctuations and lack of liquidity will drive you crazy."

—*Byron Roth, CEO, ROTH Capital, Microcap Superstar*

"Microcaps are a three-card-Monte play. If you don't know how to play, stay away."

—*Greg Sichenzia, founding partner,*
Sichenzia Ross Friedman Ference LLP,
Microcap Superstar

The market is not simply a digital machine executing trades, reflecting buy and sell orders, and recording price movements. The market does not operate as an island unto itself. The market is an extension of the investors who bring it to life every day, investors who breathe into it all their prejudices, presuppositions, knowledge and lack of knowledge, needs, hopes, and fears, rational and irrational. Apply this truth to the microcap asset class and we are left with volatility and inefficiencies extraordinaire.

—Dave Gentry

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Preface

The men you will meet in this book have spent much of their careers investing in smaller-cap companies. They have endured the test of time, making millions and in some cases hundreds of millions, through hard work, integrity, and a great capacity for risk, and perhaps, most important, the smarts to seize opportunities before others see them.

A college professor once reminded me that great things often happen in small places. The airplane was not invented at Harvard or MIT; it was invented by two brothers from Millville, Indiana, in Kitty Hawk, North Carolina. Starbucks was founded in 1971 in Seattle, Washington, as a small store selling roasted whole coffee beans. Apple started in a garage in 1976 selling computer kits, initially funded with a $10,000 investment. Caremark, the first home healthcare company, was a spin-off of a struggling biotech company that was funded by John Pappajohn, the Greek tycoon and Microcap Superstar.

Interclick, an Internet advertising company, was the brain child of Barry Honig, the most prolific microcap player today. In 2008 it was a $2.00 stock. A few years later, Yahoo! bought the company for $270 million. Subway started as a small sandwich shop in Bridgeport, Connecticut, 49 years ago with a $1,000 investment. Today, Subway has 39,500 franchises and generates $9.05 billion in annual sales. Phil Frost, the wealthiest Microcap Superstar, purchased a small company struggling to make payroll called Key Pharmaceuticals, in 1972. Fourteen years later he sold it to Schering-Plough for $800 million. Big companies start small.

Cardiac Pacemakers, founded in January 1972 by Microcap Superstar Manny Villafana, went public as a pink-sheet, over-the-counter stock, raising $450,000 on May 26, 1972. Six years later, Eli Lilly (NYSE: LLY) purchased the company for $127 million. They later spun it out under the name Guidant, which was purchased by Boston Scientific in 2006 for $24.6 billion.

Most of the men in this book I have known personally. Those I have not, I either met for the interview for this book, or learned about from my own research or through close friends or colleagues who know them well. This is by no means an exhaustive list of the Superstars in microcaps. There are others who deserve to be on this list whom I simply do not know, or whom I have not interviewed, and a few whom I know well, but who wish to continue their careers in relative anonymity.

The men you will meet in this book have spent much of their careers investing in smaller-cap companies. They have endured the test of time, making millions, and in some cases hundreds of millions, through hard work, integrity, and a great capacity for risk, and perhaps most important, the smarts to seize opportunities before others see them. None of the men in this book have been successful on every deal. Not every stock they have invested in, funded, started, or transacted business for has succeeded. In fact, some of the companies they were involved with have been miserable failures.

But they are all experts in the microcap space; all have something to teach us about investing in smaller-cap companies. These men are the crème de la crème of Wall Street's small stock community. They can go head-to-head with the best and brightest at the biggest research and investment banking firms on Wall Street. What is interesting about this group of individuals is they did not necessarily make a conscious decision to build careers in this asset class. It was much more likely that they found themselves early in their careers and, in some cases, as earlier as high school, around mentors who helped endear them to the world of smaller-cap stocks.

Michael Corbett, for example, who manages three funds for Perritt Capital Management, was mentored by Dr. Perritt, who was a professor of finance at DePaul University in the 1980s. He would take classes from him, and after getting his MBA go to work for him as an analyst. He now owns the funds he manages.

Barry Honig, mentored by his father, a successful Wall Street entrepreneur, started reading the *Wall Street Journal* while he was in high school, and after starting his career as a trader realized he could make more money buying and selling and investing in small stocks.

David Maley went to college thinking he would be a doctor or an engineer, but then he took a class called Investments, and then another called Advanced Investments, both taught by Sarkis Joseph Khoury, PhD, a prominent economist whose focus is international finance, mergers and acquisitions, debt restructuring, and speculative markets. Taking these classes changed David's thinking about what he wanted to do with his life. In 1981, while in his junior year at the University of Notre Dame, he changed his major to business.

I want to note that I am not an analyst, nor have I ever been a stock broker, fund manager, or registered investment advisor. I am an entrepreneur who has spent the past 15 years working the microcap street, most of it as the president and owner of RedChip Companies, an investor relations, media, and research firm focused on smaller-cap companies. I will be the first to admit that I have made my share of mistakes in this business. There are companies that I believed in with strong conviction that failed; there are many that have yet to live up to my expectations. I have represented more than 400 public companies over the past 18 years. I have badly misjudged management teams, grossly overvalued the prospects of companies, and missed seeing red flags that I should have. I have also been conned a few times by CEOs who were simply disingenuous in their representations of their companies. Through it all, I continue to learn and grow.

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All of the men in this book I consider self-made, though some enjoyed the benefit and inherent advantage of Ivy League educations, such as Phil Sassower, Charles Diker, and Phil Frost. Indeed, we can learn a great deal from these men about how to make money investing in microcaps. We can also learn from their application of timeless principles of success: the importance of a strong work ethic, the importance of continuous education, and daily habits that lead to success, like getting up at 4:30 a.m. every day and reading the financial papers, as John Pappajohn, one of the all-time greats in the microcap space, has done for 55 years.

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I want to thank first and foremost my wife, Clare, for giving me the time and space to write, think, and reflect over the past 12 months as I worked on this book. She has been gracious and supportive in so many ways. Second, I want to thank the RedChip team, particularly Thomas Pfister, my research director, Paul Kuntz, my communications director, and Alan Bracamonte, who spent long hours designing and laying out the book. I would also like to thank all of the Superstars in this book for lending me their time to learn about their remarkable stories.

Contents