

SCD Top 10 Under 10

We're going to do something we've never done before. Paul and I were apprehensive about doing this.. but Keith convinced us. Today, we are revealing the ideas from our watchlist. Ideas we are researching RIGHT NOW.. and haven't told a soul about. Until now..

As a spin on the Forbes "30 under 30" list, we are doing it in the format of a "Top 10 under 10" list -- that is 10 stocks under a \$10 million market cap. Just like Forbes celebrates entrepreneurs for their youth, we are celebrating these companies for their small size. Where these companies might lack in scale, they more than make up in growth potential. Many of our biggest winners -- like [XPEL Technologies \(DAP-U.V, XPLT:PINK\)](#) at \$.14 and [Covalon Technologies \(COV.V, CVALF:PINK\)](#) at \$.15 -- came from buying in well under a \$10M market cap.

Our key to success has always been to focus on the least discovered parts of the market. To do this, we have to comb through hundreds of companies just to find a handful that meet our criteria.

Every year around December we go through every publicly traded company in Canada -- except the ones with "mining" or "resources" in their name. We then compile a list of all the companies that meet our strict criteria:

- 1) **Growth** - quarterly revenue growth >25%.
- 2) **Profitability** - two consecutive quarters of positive net income.
- 3) **Size** - we want companies <\$10M market cap. The smaller, the better. A tight share structure is also a bonus -- we want to see <25M shares outstanding.

Our list today is the best 10 companies we could find that meet these criteria. Many also score highly on our bonus criteria -- things like high gross margins and inside ownership. It's a lot of work to narrow the world down to just 10 companies -- and we may only end up investing in 1 or 2 of these. But our experience is that's all you need to make a hugely profitable year.

For each company we'll give you some key facts and a list of pros/cons. Then we'll give you the bottom line on if we are buying or passing and what we'd need to see to invest. The stocks are ordered from least attractive to most attractive. Enjoy!

*** Now remember these are just ideas. These are not SCD picks. We've done early research on them but nowhere near our full due diligence. We wouldn't be surprised to see a few of these stocks at \$0 at some point. Invest at your own risk!*

*** The data in the key facts was taken from our screening software (screener.co). We've done our best to fact check the data but can't guarantee all the figures are accurate.*

10) BluMetric Environmental (BLM)



Key Facts:

Ticker: BLM.V

Price: \$.20

Market cap: \$5.6M

Shares outstanding: 27.9M

Revenue (Trailing Twelve Months - TTM): \$5.1M

Net Income (TTM): \$729,000

Revenue growth last quarter (year-over-year - y/y): 40.7%

P/E: 7.7

What it does: BluMetric specializes in designing and building environmental treatment systems. They do everything from environmental remediation projects for mining sites to maintaining water purification systems for the Canadian military.

The water treatment division is the focus for BLM -- it has higher growth and margins than the more commoditized environmental services division. This is a business characterized by large projects and thin margins. A few contracts can make or break a quarter for BLM.

Pros:

- **Scale / Revenue growth:** BluMetric posted 40% year-over-year revenue growth last quarter. BLM also has a large revenue base for a company its size, doing \$33.5M in Fiscal 2015 . While profits are small, this revenue base could make BLM an attractive acquisition target.
- **Revenue diversity:** BLM does a lot of international business for a microcap. Over 12% of their revenues come from outside the US & Canada -- this allows growth in one region to offset a slowdown in another.

Cons:

- **Debt Load:** BluMetric has been in violation of its debt covenants for years now and is operating under a forbearance agreement with their lender. If an unexpected bad event was to happen to BLM, their lenders could push them to bankruptcy. This is among the biggest risks investors can take.
- **Challenging industry:** General contracting is a tough market to invest in. Margin are thin, competition is high, and a few project mishaps can cause bad results in a hurry. We saw this in 2014 when delays and cost overruns caused BLM to lose \$2.0M for the year (excluding goodwill impairment charges).

Bottom Line: Recent success in the water treatment business has us interested but we need to see a few more high growth quarters to confirm it's sustainable. Unfortunately, there is not much else to get excited here: the professional services business is stagnant and barely profitable -- and BLM could be in serious trouble if their lenders stop cooperating with them.

We will be watching from the sidelines to see if success in the water filtration business can get the company to profitability and a better financial position.

9) Sigma Industries (SSG)



Key Facts:

Ticker: SSG.V

Price: \$.09

Market cap: \$1.06M

Shares outstanding: 11.7M

Revenue (TTM): \$49.7M

Net Income (TTM): \$1.25M

Revenue growth last quarter (y/y): 17.4%

P/E: 0.8

What it does: Sigma Industries manufacturers metal components for all kinds of industrial applications. Their parts are used in the heavy-duty truck, machinery, agriculture, and wind energy markets. Heavy duty trucking is SSG's main focus -- this market makes up almost 70% of their revenues.

Pros:

- **Cheap valuation:** SSG currently has a P/E ratio of 0.8. Yes you read that right.. less than 1X earnings. Though there are a few caveats we will discuss in the cons, you

almost never see a company trade this cheap -- much less a growing industrial with over \$40M in annual sales.

- **Turnaround success:** SSG is coming out of a multi-year program to refocus their business on what they do best: manufacturing for the heavy-duty truck market. The result has been big growth and increasing margins -- operating margins increased from .3% in Fiscal 2014 to 6.9% in Fiscal 2015. If this trend continues, it could bring big profits to SSG.

Cons:

- **Lots of debt:** Manufacturing is a capital intensive business and SSG has lots of debt to prove it. They have \$11.5M in debt on the books -- that's almost 10X the market cap of the company.
- **Dilution overhang:** If all of the 4 convertible debentures SSG has outstanding converted, that would add 42.5M shares to their count. That's close to 400% dilution potential. Seeing as all but 3.5M convert at \$.10 and don't expire until December 2018, investors must account for this dilution reality.

Bottom line: SSG looks to good to be true but after accounting for debt and dilution, the P/E on an enterprise basis comes to 13.1 -- a far cry from 0.8. SSG is still a solid, growing business but we can't get excited about this one until their debt and dilution overhang come down to manageable levels.

8) Biorem (BRM)



Key Facts:

Ticker: BRM.V

Price: \$.305

Market cap: \$4.7M

Shares outstanding: 15.4M

Revenue (TTM): \$12.7M

Net Income (TTM): \$1.08M

Revenue growth last quarter (y/y): 82.8%

P/E: 4.4

What it does: Biorem sells air emission control systems. Their systems eliminate odors and pollutants from air streams. Industrial clients like refineries and chemical plants are required by law to maintain strict air quality standards. BRM has more than 1,000 systems installed across the world.

Pros:

- **Record backlog:** BRM reported \$17.6M in orders at the end of Q3, up 29% from Q3 last year. This bodes well for future revenue growth.

Cons:

- **Lumpy results:** BRM depends on a few large projects per year. Reduced demand like we saw in 2014 dropped revenues 45.5%. The timing of projects can also cause wild swings by quarter.
- **Dilution potential:** BRM has just 14.1M shares outstanding, but over 22M additional shares are issuable from convertible debt. Our experience is dilution overhang can put a lid on the share price even when business fundamental are improving.

Bottom Line: The increase in backlog is encouraging, but BRM is far from the business we like investing in. Low gross margins and lumpy revenues cause wild swings in profitability we like to avoid. That plus the debt load and messy share structure means we are taking a pass on this one for now.

7) Redishred Capital (KUT)



Key Facts:

Ticker: KUT.V

Price: \$.24

Market cap: \$6.9

Shares outstanding: 28.9M

Revenue (TTM): \$5.13M

Net Income (TTM): \$800,000

Revenue growth last quarter (y/y): 25.9%

P/E: 8.7

What it does: Redishred owns and operates a network of document shredding stores. Businesses with sensitive documents, such as hospitals and law firms, are required by law to securely destroy records after certain time periods. Much of KUT's business comes from "scheduled" shredding, which is repeat business from their clients.

Redishred is split into two business models: franchising and company owned stores. With franchising, Redishred licenses their brand to a third party who operates the stores -- in return KUT gets royalties. For company-owned stores, KUT is responsible for all of the expenses to run it -- but they also get all the revenues.

Pros:

- **Recurring revenues:** we like businesses with a predictable stream of repeat business. KUT rates highly here -- 47% of their business is from recurring scheduled shreadings.
- **Repeatable growth:** one plus of retail companies is they often have a predictable growth path. If there is untapped demand out there, they can grow by adding locations. Redishred has been able to add locations each year -- they have 6X the locations they had just a decade ago.

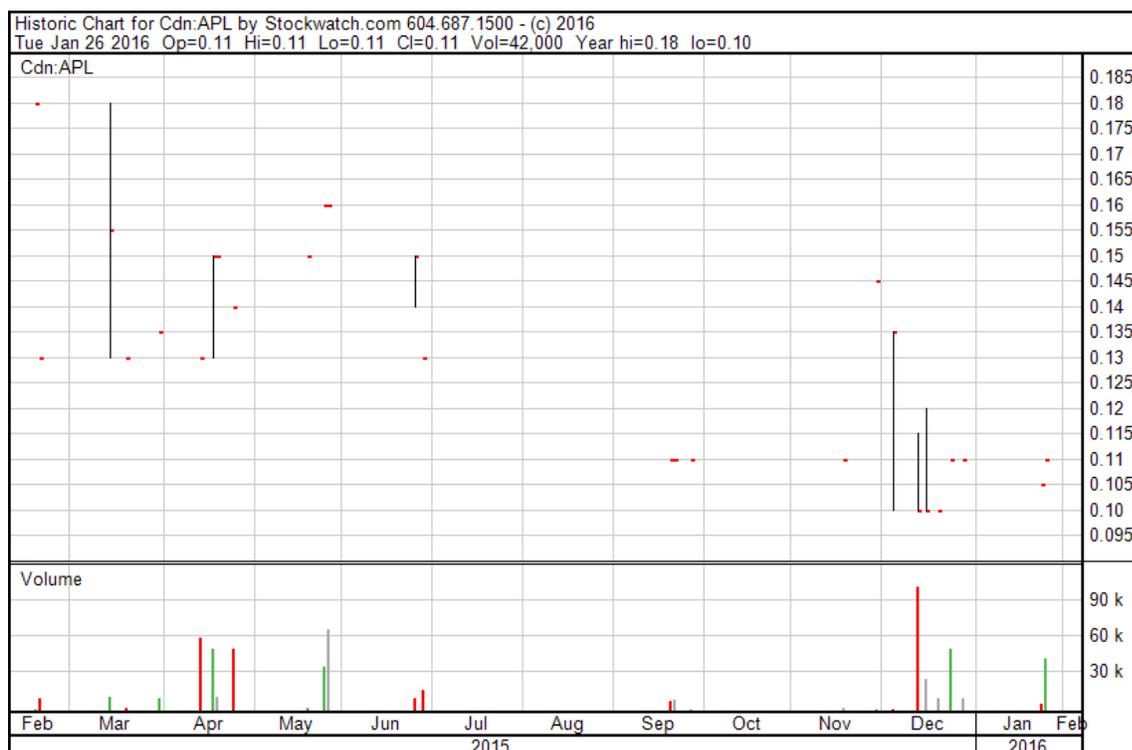
Cons:

- **Inflated growth rates:** KUT reported headline "system sales" growth of 36% y/y last quarter. Sounds impressive -- but account for the percentage of system sales that turn into revenues and the move in the CAD/USD exchange rate -- and you'll see a true growth rate of just 4.6%.
- **Debt load:** Much of KUT's growth over the last decade has come from acquiring private shredding businesses. This strategy has loaded them up with debt -- total debt is now \$7.4M against just \$900K in cash.
- **Complicated story:** We like simple stories.. the kind you can explain to a 10-year old. By combining a franchising model and company-owned store model, we have a hard time making sense of the company's true growth rate and margin profile.

Bottom Line: Redishred is one of those stocks that seems to always be atop our watchlist -- but never quite makes it to purchase. It posts consistent headline revenue growth and profits,

and has a solid recurring business. But we are always left wondering how much of their growth is organic and how much must be bought through acquisitions. Until we understand their growth path better, this one is staying on the watchlist.

6) Appulse (APL)



Key Facts:

Ticker: APL.V

Price: \$.12

Market cap: \$1.6M

Shares outstanding: 13.0M

Revenue (TTM): \$6.0M

Net Income (TTM): \$140,000

Revenue growth last quarter (y/y): 32.3%

P/E: 8.1

What it does: Appulse's business is as simple as it gets. They sell centrifuges -- both new machines and parts to maintain them. A centrifuge is a machine that spins particles at high speeds. It is often used to spin liquids to separate solids from them.

Appulse's main market is the food industry. Their centrifuges are used in the dairy industry to separate milk into skim milk and cream. Appulse also sells into the oil & gas and waste water treatment markets. Machine sales make up ~25% of APL's revenue, with higher-margin parts and services revenue making up the balance.

Pros:

- **Growing high-margin revenue:** While machine sales fell 11% for the 9-months ended September 30th, 2015, parts and service revenues grew 20%. The company cites a partnership with Flowteg Separation Technology driving the increase in parts revenues. Given that parts are higher-margin, if this trend continues it could mean big profits for APL.
- **Valuation:** At less than 8X trailing earnings, APL is valued quite low for a company growing revenues double-digits. APL is also cheap on an asset basis, trading at 75% of its net working capital (current assets - current liabilities).
- **Ownership structure:** Insiders have a lot of skin in the game. The president owns 30% of the shares and insiders combined own over 45%. We also like the tight share structure with under 13M shares outstanding and minimal potential dilution.

Cons:

- **Low margins:** Selling centrifuges is a commodity business. Commodity businesses usually mean one thing: low margins. With just 25% gross margins, little of APL's topline growth is making it through to the bottom line.
- **Cyclical:** APL's business, especially new machine sales, is sensitive to the economy. This revenue stream can decline rapidly once business softens and their customers stop upgrading to new machines.

Bottom line: APL's business is far from sexy -- but it has many of the fundamentals we like to see: solid growth, profitability, and a cheap valuation. There are two trends we are watching -- we want to see where machine sales bottom and how fast parts and services can continue to grow. If parts and services can boost margins and get APL to over \$100K per quarter in profits, we will start getting excited about this one.

5) Alliance Pharmaceuticals (APA)

Key Facts:

Ticker: APA.V

Price: \$.34

Market cap: \$8.3M

Shares outstanding: 24.5M

Revenue (TTM): \$5.1M

Net Income (TTM): \$-937,000

Revenue growth last quarter (y/y): 145.0%

P/E: N/A

What it does: Alliance is in the business of providing pharmacist replacement services to pharmacies in Quebec. When pharmacies are short-staffed or offer extended hours, they often need temporary labor. This is where Alliance comes in.

Pros:

- **High growth:** Revenues grew 145% year-over-year last quarter. This is some of highest growth we've seen in the smallcap world, although most was driven by a large acquisition.
- **Market presence:** Alliance controls 75% of the Quebec pharmacist replacement market. We like companies with scale that dominate their niche.

Cons:

- **Unprofitable:** Alliance took on a lot of overhead quickly by going public via an RTO in January 2015 and then making a major acquisition just three months later. Last quarter was their second profitable quarter since the RTO. They did \$23,000 in net income -- hardly enough to justify an \$11M valuation.
- **Regulatory:** There are laws being enacted in Quebec that increase the scope of work pharmacists are responsible for -- but not all of this work will be paid for. The company worries these laws could lower the attractiveness of the pharmacist career.
- **Competitive Industry:** The temporary labor industry has almost no barriers to entry and the company faces fierce competition. This puts a cap on margins and could make it hard for the company to grow.

Bottom Line: Alliance has shown good growth but we need to get a better handle on how much of that is sustainable, organic growth. We also need to see a few quarters of integrating their acquisition and confirm Alliance will be cash flow positive going forward.

4) AirIQ (IQ)



Key Facts:

Ticker: IQ.V

Price: \$.09

Market cap: \$2.6M

Shares outstanding: 28.9M

Revenue (TTM): \$2.32M

Net Income (TTM): \$271,000

Revenue growth last quarter (y/y): 31.6%

P/E: 9.6

What it does: AirIQ sells GPS tracking systems that allow owners of vehicle fleets to manage their assets. Their hardware is stealthy placed in a vehicle and allows owners to track their fleet in real-time and protect against theft. Rental car companies are major clients for AirIQ.

AirIQ's management estimates they have a dominant market share of the North America fleet management market. Over 70% of their revenues come from recurring airtime fees. AirIQ rents the GPS hardware to clients and provides services under 2-3 year service contracts.

Pros:

- **Recurring, long-term contracts:** Over 70% of AirIQ's revenues are recurring -- and with most of these coming under multi-year contracts, they should maintain a stable revenue base for years to come.

- **3G upgrade cycle:** AirlQ's wireless carrier recently decided to sunset 2G connections, which is what most of AirlQ's and their competitors' customers were on. This started an upgrade cycle that has allowed AirlQ to capture new business. While margins have been strained as they upgrade their existing customers to 3G, margin expansion should happen once the upgrade is complete.

Cons:

- **Obsolescence risk:** As Marc Andreessen (founder of Netscape) famously said, "software is eating the world." What you once needed a Garmin GPS to do, you can now do with an iPhone and Google Maps. It's not hard to imagine a competitor coming along and doing the same to AirlQ's fleet management platform.
- **Dependence on wireless carriers:** AirlQ doesn't own the airwaves, they rely on carriers like TELUS to power their communication network. Their carrier's decision to sunset 2G cost AirlQ a lot of money (though it also provided opportunities) and AirlQ will be at their mercy for the foreseeable future.

Bottom Line: Judging by the numbers, AirlQ looks like a winner. Revenues have been growing 20+% and earnings have been growing even faster -- 100+% year-over-year. And you get all this growth for under 1X sales and under 4X annualized EBITDA. The issue for us is the business model -- we need to be sure an app won't come along and eat IQ's lunch. We see solid near-term upside but confess there is more work to be done here.

3) Acceleware (AXE)



Key Facts:

Ticker: AXE.V

Price: \$.015

Market cap: \$993,000

Shares outstanding: 66.2M

Revenue (TTM): \$1.88M

Net Income (TTM): \$-248,000

Revenue growth last quarter (y/y): 61.6%

P/E: N/A

What it does: Acceleware sells high-power computing solutions primarily to the oil & gas market. Their solutions are used by seismic interpreters who must look at massive amounts of data to find oil reserves.

Their software uses parallel computing that can increase seismic processing speeds by 10 to 50 times. We are not smart enough to tell you exactly what their software does... but with major clients like Repsol, Nokia, and Samsung, it's clear their product is working in the market.

Pros:

- **Valuation:** Much like IBEX, AXE is another growing, profitable company trading for less than a public shell would command (\$1M).
- **Niche dominance:** Mega companies like to buy technology from other large, well-capitalized companies. Seeing Repsol and Nokia take a chance with AXE tells us they must be filling a niche few other companies can.
- **Growth:** Despite the oil & gas slowdown, AXE reported 62% year-over-year growth last quarter. This tells us AXE's technology is being adopted and they could be in a good position if/when oil rebounds. They also have ~\$1.5M from the Repsol contract left to be recognized, which should support revenue growth during the slowdown.

Cons:

- **Oil & Gas exposure:** When an entire industry downturns, spending on fancy technology is usually the first to get cut. The oil price crash hit AXE hard in Q1, with revenue falling 51% year-over-year to just \$329K.
- **Balance sheet:** AXE had just \$250K in cash at September 30th, down from \$634K since 2015 began. Most of AXE's revenue is project based -- meaning they must use resources to deliver ahead of getting paid. If any of AXE's oil & gas clients were to default, they could be in trouble.

- **Low insider ownership:** we like smallcaps where insiders own 30+%. We also like it when the CEO owns 3X+ in stock than his salary. AXE falls short here -- the CEO owns just 2.34% of the shares valued at \$20,000.

Bottom line: AXE hits just about all of our key criteria: niche dominance, rapid growth, and cheap valuation. The only thing it's missing is two consecutive quarters of profits. We will be watching for AXE to grow its recurring software revenues and reach consistent profitability. In the meantime, this one will be at the top of our watchlist.

2) IBEX Pharmaceuticals (IBT)



Key Facts:

Ticker: IBT.V

Price: \$.105

Market cap: \$2.6M

Shares outstanding: 24.7M

Revenue (Trailing Twelve Months - TTM): \$3.07M

Net Income (TTM): \$591,000

Revenue growth last quarter (year-over-year - y/y): 125.5%

P/E: 4.4

What it does: IBEX produces and markets enzymes for the biomedical industry. Their products are primarily used in a medical setting to neutralize the effects of herapins and herapinoids, two

drugs commonly used in hospitals. IBEX also sells diagnostics kits used to test patients for arthritis.

Pros:

- **Strong growth:** IBEX grew revenues last quarter (fiscal Q1) 126% year-over-year to \$1.4M. This was an all-time record for IBEX.
- **Financial strength:** IBEX has \$2.6M in cash and \$3.6M of net working capital against just \$1.1M in debt. We like that all this debt is long-term (20-yr) at attractive rates (4.25%). It's just like a mortgage.
- **Valuation:** IBEX is trading for less than its net working capital. Warren Buffet was famous for buying companies that met this criteria. We rarely ever see growing, profitable companies trade for less than their cash on hand.

Cons:

- **Customer concentration:** Just three customers made up 58% of IBEX's sales in Fiscal 2015. The loss of one customer in Fiscal 2014 caused the company to stagnate for over 2 years.
- **Inconsistent results:** Because of customer concentration, IBEX's results can swing wildly quarter-to-quarter.
- **Sustained growth:** Management notes much of the growth last quarter was due to customer timing -- not increased demand. IBEX has also had a large boost from the CAD/USD exchange rate. Almost 100% of their sales are US-based.

Bottom Line: Cash flow-positive biotechs are some of our favorite investment plays. We like their non-cyclical business models and high gross margins. We especially like IBEX's valuation: less than net cash and ~10X operating earnings.

Our main concern with IBEX is the customer concentration and inconsistency of results. We'd like to see another quarter to confirm the company's growth is sustainable and profitability can be maintained. The valuation is cheap, and it wouldn't take much for us to get excited about this one.

1) Cencotech (CTZ)



Key Facts:

Ticker: CTZ.V

Price: \$.25

Market cap: \$8.3M

Shares outstanding: 27.3M

Revenue (TTM): \$6.8M

Net Income (TTM): \$-619,000

Revenue growth last quarter (y/y): 7.6%

P/E: 11.0

What it does: Cencotech sells currency management software. Their software allows businesses with lots of bills, like banks and retailers, to track their cash in real-time. Their largest customer is Brinks Security -- the armored vehicles that transport cash for retailers and banks. Brinks white-labels CTZ's software and sells it to their retail clients as part of their cash management offering.

Pros:

- **Hidden growth:** CTZ grew revenues 26.7% year-over-year in Fiscal 2015. They did this while moving from a licensing model to a software-as-a-service model, sacrificing large

up-front payments for small monthly recurring fees. This tells us true business growth was likely higher than 25%.

- **Industry Trends:** The Federal Reserve has decided to offload their currency management functions to banks. This means banks must now buy the software CTZ offers. CTZ is one of the few players in this industry and should be well positioned to capture new business.
- **Inside ownership:** CTZ's CEO owns 35% of the shares outstanding.

Cons:

- **Customer concentration:** Three customers make up 48.6% of CTZ's revenues and just one customer (Brinks) accounts for 30%.
- **Management communication:** CTZ is an unknown stock and there is little communication from management on the state of the business. In many ways, it is run like a private company.

Bottom Line: CTZ dominates a niche in an industry with the wind at its back. That along with growing recurring revenues and a cheap valuation make this a buy for us. We also like that the company is debt-free and has no need to raise money in this market.

We expect management to stay quiet but feel it's only a matter of time before growing recurring revenues and cash flows get noticed by the market. We're long this one.

Wrapping Up

So there you have it, 10 completely unknown companies that meet our key criteria. We can't promise all -- or even some of these -- will be winners. But our experience is tiny, cash flowing smallcaps is the fastest route to big profits.

We will be hard at work over the coming months researching these companies -- and we invite you to research alongside us. Come share your thoughts on these companies at the Smallcap Discoveries forum (if you haven't got set up, email DJ). Together, we might just find the next 10-bagger on this list.

To your wealth,

Paul & Brandon