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White Paper Study

"How to be a Thirty Dollar Stock in Five Years"

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INTRODUCTION

There are many benefits to being a publicly traded company, including but not limited to: 1) having greater human resource credibility to hire and retain qualified and reliable personnel; 2) having greater financial disclosure credibility, to render confidence to companies and investors; 3) having the ability to issue shares and raise capital; having shares with an appropriate valuation that could be used toward being acquired or making an acquisition; and 4) having a better exit strategy for original investors A public company can especially put themselves in a position to benefit from the previous points if they keep their shares outstanding low, their debt next to zero, their burn rate low, and have increased earnings. This will give them an excellent looking balance sheet. This is what is motivating investors to invest in companies these days. Due to the Dot.Com demise of the 1990's and the Mortgage Crisis of 2008, gone are the days that people will invest in anything, just based upon a good story.

Many companies become publicly traded on the Stock Market (NYSE; AMEX; NASDAQ; OTCBB) without having a clear perspective of how their stock will fair in the public market. In one sense of the matter, this is not necessarily a bad thing. Companies constantly striving towards profitability, with good old fashioned hard work, should ultimately reflect positively in how their stock price performs. On the other hand, companies that witness challenges generating profits, often fall prey to deviating from the business model that made them successful when they were privately held entities.

As a publicly traded company, there are significant pressures and responsibilities associated with expenses, as well as accountability to shareholders. When these new pressures begin to overwhelm the publicly traded company, sometimes the company makes erratic management decisions that it would not normally make had they still remained private. Having said that, and despite all of the ideas and suggestions that a company will receive as a publicly traded company, the first and foremost responsibility that a company should have is: Shareholder Value. Shareholder Value comes with outstanding performing financials, having a compliant corporate governance program, and an eventual price appreciation of its stock.

The White Paper study, herein, ***How to be a $30.00 Stock in Five Years***, will provide insight of basic and essential fundamentals in which ALL companies should adhere, no matter the state of their company. If a company works hard, and follows the structure and strategy outlined below, then the potential of a company becoming a $30.00 stock over the next five years becomes more and more realistic. As with many things in life, the whole process works in a structured, step by step process.

More Incoming than Outgoing:

Remember to always accomplish one primary objective: Earnings, earnings, and more earnings! It is also important and vital to keep expenses, burn rates, and any debt next to nothing. The key is to organically grow a company with earnings and keep overhead expenses and the monthly burn rate to a minimal. The basic financial and accounting premise of having more incoming dollars versus outgoing dollars needs to be strictly honored; otherwise a company may fall into the habit of trying to function their company on debt instead of growing out their company with revenue.

A company should want to have zero debt on their books. Interest expenses associated with debt, weigh down the balance sheet, and ultimately hurt a company's earnings. Companies heavily constricted by debt, spend more time paying the interest on its debt, versus reinvesting those same dollars back into the company, to grow greater grow the company. Also, early going, they should try keeping their Shares Outstanding low, so supply and demand can occur in the market with their stock. Any growth, early on, would primarily have to be stimulated through re-investing revenues back into the company.

The most successful companies in the stock market are the ones that can keep their earnings high and grow them by 10 to 12% per quarter. Current quarterly earnings per share should be up a major percentage - at least 25% to 50% or more - over the same quarter of the previous year. At minimum you need to grow your annual earnings by 36% per year, over a three year period. Studies show that between 1980 and 2000, the median annual growth earnings rate of all outstanding stocks at their early emerging stage was 36%.i Similar models show that the 600 best performing stocks from 1952 – 2005, had earnings increases averaging more than 70% in the latest publicly reported quarter before they began their major advances.ii

Successful companies also need to have a current ratio equation of at least 2 to 1. Current ratios are the sum of Current Assets divided by Current Liabilities.iii Current Assets are assets that may be converted into cash, sold or consumed within a year or less. They usually include cash, marketable securities, accounts receivable, inventories and prepaid expenses. Current Liabilities are liabilities that have to be paid or satisfied within one year. Includes accounts payable, notes payable, taxes, wage accruals and current portions of long-term debt.

Management and Structure

An astute early stage publicly traded company prides itself as a leader in a fragmented industry with a business model that generates recurring revenue. A fragmented industry is an industry that is non-professionalized, dominated by mom and pop operators. A fragmented industry can be consolidated and rolled up in a series of mergers to add strength and growth to a company. Moreover, proactive companies are always working on strategic partnerships to grow their company; but always ensure that they have bread and better revenue occurring to cover their burn rate and overhead. This is a key factor, as a company does not want to run short on money, where they have to issue further debt or equity without the revenue to substantiate it, to simply cover expenses. This will tarnish their financials, which will hurt the price of the stock.

Institutional and Retail Investors will always analyze management's efficiency based upon a company's Return on Equity (ROE). Studies by the Investors Business Daily newspaper show that the greatest winning stocks of the past 50 years had ROEs of at least 17%.iv One of the quickest ways to gauge whether a company is an asset creator or a cash consumer is to look at the return on equity that it generates. ROE is Net Income / the book value of Shareholder Equity. Shareholder equity can be found on the balance sheet and is simply the difference between the total assets and total liabilities, as it is assumed that assets without corresponding liabilities are the direct creation of the shareholder's capital that got the business started in the first place.

A business that creates significant shareholder equity is a business that is a sound investment, as the original investors in the business will be able to be repaid with the proceeds that come from the business operations. Businesses that generate high returns relative to their shareholder's equity are businesses that pay their shareholders off handsomely, creating substantial assets for each dollar invested. These businesses are more than likely self-funding companies that require no additional debt or equity investments. Return on equity helps separate the well-managed companies from the poorly managed ones. It tells us how efficiently management is making use of the money with which it has to work.

Early going as a publicly traded company and also as a micro - cap stock, the correct strategy for a company is to issue a small amount of shares outstanding, so you can post positive Earnings per Share (EPS) as quickly as possible. The least amount of shares you have, the quicker you can post positive EPS. EPS is Net Income divided by Shares Outstanding. During and thereafter, the company should focus on keeping expenses down and continuing to post positive EPS. That will always be the mantra. EPS, and more EPS; growing by 10 to 12 per cent per quarter. This is important. That's what Wall Street likes. Cash Flow and income always have to be growing through expansion. This is so important early on, because you will be building your reputation. Most of the market will not know who you are until you start posting earnings.

Strong improved quarterly earnings should always be supported by sales growth of at least 25% for the latest quarter or at least acceleration in the rate of sales percentage improvement over the last three quarters. One example is Waste Management. Some professional investors bought Waste Management at $50 in early 1998 because earnings had jumped three quarters in a row from 24% to 75% and 268%. However, sales were only 5%. Several months later the stock collapsed to $15 a share.v What this demonstrates is that earnings can be inflated for a few quarters by cost reduction or reducing research and development (R&D), depreciation, reserves, advertising, or other constructive activities. However, to be sustainable, earnings growth must be supported by sales increases. Such was not the case with Waste Management. The street viewed this as having no real tangible growth.

What Makes a Stock Go Up or Go Down

How and why does a stock go up and/or down? In the basic realm of things, it is all supply and demand. If there is more buying than selling with a limited supply of shares outstanding, a stock will go up. If there is more selling than buying, with a greater supply of shares outstanding, a stock will go down. Earnings are normally the driving force behind this. Positive earnings work in favor of a stock price to potentially go up; and negative earnings work toward a stock price to potentially going down. Sometimes companies can get by for about a quarter, with news releases of significant progress that can lead to earnings. Without any tangible news and without any substantive revenue, then selling in a stock could start to take place. With an excessive supply of stock and little demand, a stock has greater probability of going down versus up. The more selling that takes place, the lower the price of the stock will go. Hence, there is no incentive for people to buy the stock if there are no positive earnings associated with it. Do you know why many stocks end up trading in the pennies vs. dollars? Primarily, because the companies get themselves in financial trouble. They then have to continuously issue more shares to raise capital to support their overhead. Hence, they become over diluted. Once they have too many shares outstanding, it becomes difficult for them to report positive EPS. Once again, EPS = Net Income / by total shares outstanding. Once again, not only do you have to have positive EPS, but you should be able to grow your EPS by 10 to 12% per quarter. The best structure to do this is with a limited amount of shares outstanding. Essentially, too many shares outstanding cause dilution which makes it impossible to post positive EPS, which makes it difficult for any large buyers to want to buy your stock. Thus, the stock goes down to pennies because of all of the selling.

Furthermore, such dilutive circumstances unsupported by positive EPS, invites the wrong type of trader or investor to buy your stock. Unfortunately, there are "short sellers" out there that prey upon companies knowing that there is no possible way that a company will post any type of positive earnings in the near future, which would allow their stock to go up. Thus, these "short seller" traders are constantly working against the price of your stock going up. The only thing that would concern them to have to cover their short position is if your company posted positive earnings, as positive earnings are the foundation that could propel as stock issuance to trade higher.

Hence, in the early and initial inception of a publicly traded company's evolution, a stock should trade thinly, with low volume and a small amount of share outstanding. A "tight float" will allow a company to easily monitor who are the real long term investors of the stock vs. who are the short sellers trying to work against the stock. Moreover, a thinly traded stock will keep the short sellers at bay, as it becomes more difficult to short sell a thinly traded stock.

Personally, I have witnessed companies that had tight floats where they would post positive earnings, and since there was no stock to be had, the stock would go up by its own function. One particular company had five million shares, issued and outstanding, where their stock only traded approximately 15,000 to 20,000 shares a day of average volume. Then, over the course of 12 months, the company increased its EPS by 10% per quarter, for four straight quarters. On the days that their earnings were announced, during each of the four quarters, since they had such successful quarters, their stock went up on its own merit, with an additional increase of volume compared to normal. Instead of trading 15,000 to 20,000 shares a day, there would be couple of days where the stock would try 25,000 to 30,000 shares, and since there was a tight float, the stock would incrementally go up, all because of four consecutive quarters of earnings. So, having a small float definitely helps. If you can show the type of earnings growth, as explained above, the stock would move up with little volume, because the float would be tight, and the demand for the stock will overcome the supply.

Once you can get to the point where you can post consistent earnings, then at that time, you can issue more shares of stock, to create more liquidity and bring capital into the company. Although the issuance of more shares will initially be deemed as dilution by the overall market (where your stock may decline a bit), once you post your next potential earnings report of potential positive earnings, your stock should rebound and hopefully continue its upward ascension.

Once you issue more shares (accompanied by positive earnings), you then want the institutions to always be aware of what you are doing. The correct strategy is to have an in-house person fax or email all of the institutions the outstanding good news that is going on with your company, just so you are on their radar. This is important, because institutions control about 80% of the volume that takes place in the market. Institutions buy in large blocks and they are normally long term holders. This is the type of investor you want behind your stock. Prominent institutional categories include: Corporate Pension Funds, Mutual Funds, Bank Trust Departments, Insurance Investment Companies, Money Management Firms, and state, charitable, and educational institutions.

Institutions, although impressed with the potential earnings that your company may begin posting, more than likely will not invest in your stock unless there is liquidity in it, as they never want to take large positions in a stock not knowing if they can eventually sell out of it. Once you post positive earnings per share, this is when your company wants to issue more shares to create more liquidity in your stock to make your issue more appealing to institutions. With liquidity and positive earnings, institutions will potentially seek to buy your stock heavily.

Raising Capital for Acquisitions

If a company can eventually get its stock up to the $12.00 range, then the next step is to raise additional capital through a private placement at a discount to the current market price of your stock, perhaps with a one million share or three million share offering. If the earnings are there, it shouldn't be difficult to raise capital, especially since you are giving the investor a discounted price to the market. The investor in return will have to hold onto the stock for six months or longer if there is compliant lock-up agreement, before he or she can sell it, which once again gives you additional time to grow your company further with more increased earnings. If and when those shares get liquidated into the market a year later, you will now have the earnings to ward off and sustain any selling that could drive down the stock. If most investors see earnings increasing, they won't panic about the additional shares flooding the market. Basically, you issue more shares, when you have the profits and earnings to substantiate it and ward off the selling. It is important to get a stock up to a double-digit price for more than just raising capital. Once a stock is up to $12.00, it can be used as a currency to make acquisitions. One of the most important things that a company would want to do is not only use some of the cash proceeds, but most of the stock to start rolling up and consolidating the Mom and Pops and the competition in the industry. This grows the company quicker than internal growth, because you are bringing existing assets to your balance sheet. Most mom and pops would love to merge with a company if they knew they could continue to work hard and have stock valued at $12.00.

However, your acquisitions cannot be just with anyone. They should be businesses that are also currently growing their business by 10 to 12% per quarter. In addition to having a salesman going out and selling your primary product, you would also have on staff, an aggressive executive salesman for this purpose. A young CPA or MBA graduate would work the best. Instead of them calling on the companies to sell your product, they will be calling on the competition to persuade them to merge with your organization. The whole idea of the consolidation is to bring the other companies' assets to your balance sheet, which once again, will boost your stock price.

However, if you structure your company with too many shares and you have too much dilution, supply and demand will be difficult to occur in the market. Thus, if you have an off quarter, where you do not meet earnings, that can cause excessive selling (due to excessive shares) which would drive your stock to go much lower. If your stock ends up going below a dollar, you have distorted your opportunities to make acquisitions. No matter how good your operations are within the company, competitors will not merge with you knowing that the stock is only a penny stock.

Summary

In summary, a small amount of shares issued early going keeps management aware of where all the shares are, and who the friendly shareholders are. This prevents excessive selling from unknown entities that could drive down the price of the stock. A small amount of shares outstanding makes it easier for you to post positive earnings, which it makes it easier to generate supply and demand in your stock for the company stock price to go higher. A higher stock price makes it easier to raise further capital and to make acquisitions. A small amount of shares outstanding makes it difficult for short sellers to short your stock.

During your first two years trading, you want to focus on positive earnings, which could assist the stock price to go double digits, and have it sustain that price without much volume, this way the stock can be used as a credibility trophy to raise further capital and to make acquisitions. As you grow your earnings, then you can ladder out and issue more shares, as the demand picks up for your stock. If you issue too many shares early going, without the proper demand, the stock price will sink.

The only thing that can cause proper demand is earnings, earnings, earnings. Public relation programs and investor relation programs only spike the stock upward. However, anything that spikes upward whipsaws or reverses lower twice as hard. You want your stock to have a diagonal upward ascension, based upon low volume, then moderate volume, and then significant volume. The different stages of volume occur over different time lines and thresholds of success by your company's performance.

These are some of the strategies on how a company can be a $30.00 stock in five years. Everything has to be done in increments. It is important to understand that being public is not always positive. There are negatives such as having to fully disclose your company's operations and financials to the public, including your shareholders. Time and money is allocated on auditing fees every quarter. Due to the Enron debacle, Senator's Sarbanes and Oxley, implemented the Sarbanes Oxley Act, which has caused further internal controls and expenses to be placed on reporting companies. In my opinion, the positives outweigh the negatives.

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i How to Make Money in Stocks, Third Edition, William Oneil

ii How to Make Money in Stocks, Third Edition, William Oneil

iii How to Make Money in Stocks, Third Edition, William Oneil

iv How to Make Money in Stocks, Third Edition, William Oneil

v How to Make Money in Stocks, Third Edition, William Oneil

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