Investors Alley

May 2015 Vol. 1 Issue 11

Bret Jensen's Small Cap Gems

Looking for Stocks for When Consumers Spend that 'Gas Tax Cut'

In This Issue

Fellow Investor,

The S&P 500 has had a nice month adding some three percent since our last update. The Russell 2000 has been largely flat during that same time period as the market has been somewhat bifurcated recently. A lot of money has been going into some of the largest names of the NASDAQ recently with **Microsoft (NASDAQ: MSFT)** and **Amazon (NASDAQ: AMZN)** being particularly strong on the back of better than expected earnings reports in late April.

Speaking of earnings, equities have held up quite well even as earnings and revenues have flat lined year-over-year this quarter mainly because of the collapse of profit in the energy sector, the strong dollar and tepid global demand. Q1 GDP growth of just 0.2% was hardly encouraging and the recent swoon in the biotech indices are a little disconcerting as well.

Oil has traded better recently and WTI hit $58 a barrel recently, its highs for 2015 so far, before pulling back slightly. Some of the exploration and production (E&P) stocks have had impressive runs recently but I would not be adding money here in anticipation of higher oil prices. A lot of the smaller E&P stocks are actually trading higher with oil under $60 a barrel than they were in October when oil was still above $80 a barrel. A lot of good news seems to be priced in and I don't think the shakeout in the oil market is over given weak global demand, still increasing production in the United States, and the prospect of Iran moving back onto the worldwide market once sanctions are eased, probably during the summer.

Gasoline prices have moved up some but levels are still way below where they were last year. Confounding pundits, consumers have saved approximately three quarters of that gas "tax cut" and the personal savings rate recently hit 5.8%, a multi-year high. What extra discretionary income consumers have seem to be going to eating out more as restaurant sales numbers have seen a nice boost. Consumers are also buying more trucks and SUVs now that gas is under $3 a gallon, rather than closer to $4 a gallon: a positive development for one of our core holdings in **The Turnaround Stock Report**. Hopefully some of these savings will show up in better sales in other retail sectors as consumers believe under $3 a gallon gasoline might be here to stay for a while and job growth remains higher than we have seen in years.

I remain cautious on the domestic market overall. Valuations are above historical norms and earnings growth seems to have hit a standstill for at least the first half of the year. Money also seems to be flowing this year to

Europe as the ECB initiated its own quantitative easing programs. Even though the U.S. dollar has booked huge gains against major currencies over the past nine months, it still looks primed to move higher thanks to the divergence between the world's main central banks and stronger domestic economic growth here than in Europe or Japan. On the bright side, the Federal Reserve should now postpone their first interest rate hike since 2006 to September if not later in the year or even into 2016.

We are seeing increasing merger and acquisition activity as companies struggle to achieve any sort of decent organic growth and purchase financing rates remain very favorable. I would not be surprised if at least one of our portfolio positions gets bought out like **Avanir Pharmaceuticals (NASDAQ: AVNR)** by the end of the year.

This month we add a small financial play that is growing via acquisition but easily could itself become a buyout target given its low valuations and growing assets under management and accelerating presence in bond and equity underwriting. We are also boosting our exposure to retail with a small retailer that could really accelerate earnings if its initiatives to boost margins pay off.

If you ever have a question or comment you can reach me at bret.jensen@investorsalley.com.

Thank you and Happy Hunting.

Bret Jensen
Editor
Bret Jensen's Small Cap Gems

P.S. A reminder that I'll be at the Las Vegas MoneyShow May 12 – May 14 along with my Investors Alley colleague Tim Plaehn. *Full disclosure*: I am in no way compensated by them for my presentations. I just like to fill the room with my subscribers as a number of you have already told me you'll be there. I'll be doing two presentations while there: one on biotech investing and the other on how to pick through the carnage in the energy section. Plus, come meet me in person at our booth (#417) where we can talk investing strategies, new stock ideas, upcoming hot sectors. For details and to register, **CLICK HERE**

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Ladenburg Thalmann Financial Services

For our first portfolio addition for this month's issue of Small Cap Gems, we increase our exposure to the financial sector. Our pick is a small asset management and investment banking firm most have never hear of them but I am very familiar with given my location in Miami and deep interest in the biotech space.

After emerging from the brutal financial crisis of 2008, the banking and financial services industries are finally generating some solid growth. As Americans start to get comfortable with the stock market again, investment flows are starting to return to U.S. equities from the retail investor community. Many of these investors are turning to the services provided by independent brokerage and advisory firms in an effort to optimize their portfolios and meet their investment goals. In addition, the equity underwriting space is seeing some of the best activity in years.

Ladenburg Thalmann Financial Services, Inc. (NYSE: LTS) is a diversified company whose platform includes broker dealers, asset management, investment banking, life insurance products, and equity research. The firm posted record high revenue and net income in 2014. Ladenburg now offers a network of 4,000 financial advisors and $125 billion in client assets under management (AUM) thanks to organic growth and some key recent acquisitions. I am intrigued by the firm's robust range of services, upward trending growth, and notable insider buying. The company has a market capitalization of just under $700 million and surprisingly has little analyst coverage at the moment despite the company having been a member of the New York Stock Exchange for 135 years.

Offering a Diversified Range of Financial Services:

The two primary arms of Ladenburg Thalmann are its independent brokerage and advisory services (IBD) sector, and investment banking and capital markets division. The firm's IBD business maintains five broker-dealer and registered investment advisor firms as standalone operations. LTS preserves the independence of those businesses in an effort to maintain their history and culture while enabling them to leverage the technological and back office support of the overarching company.

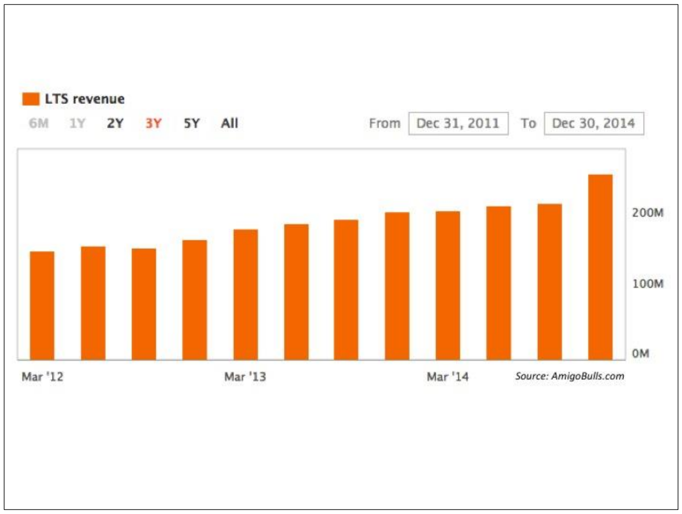
Ladenburg's advisors have access to all the resources of the company, from its capital market products and investment banking services to its proprietary institutional equity research. So far the strategy seems to be working, as recurring revenues in its IBD operations improved to a solid 71% in 2014.

The investment banking and capital markets business focuses on providing corporate finance and advisory services to public and private companies with market capitalizations below $500 million. Financing options include underwritten public offerings, registered direct offerings, and private investment in public equity (PIPEs). In 2014 the firm participated in 106 underwritten offerings that raised a total of approximately $19 billion.

Its bankers deal primarily with REITs, business development companies (BDCs), and master limited partnerships (MLPs), having participated in 206 offerings of these nature since 2012. Ladenburg also has dedicated investment bankers focused on healthcare and biotech companies. Given that noted multi-billion biotech entrepreneur and investor Phillip Frost owns a good chunk of the company, I expect Ladenburg to continue to grow in this fast growing space. The firm added a fixed income trading desk in 2012, a nice complement to the company's equity efforts since many of the customers receiving investment banking services also issue bonds and other forms of debt.

2014 Financial Results Impress:

Ladenburg Thalmann improved revenues by 16% in 2014 to just over $920 million, a record high for the company. EBITDA grew by 7% to about $61 million, and net income came in at approximately $33 million compared to a loss of just under one million dollars in 2013. In 2012 the company recorded a net loss of about $16 million, so the upward trajectory for revenues and overall net income over the past years is definitely a positive sign.



Advisory fee revenues increased by 25% year-over-year, and investment banking revenues improved by 12%. The fact that both of the company's primary operations have experienced solid growth over the past year is promising and indicative of a strong underlying business platform.

Currently analysts are expecting revenues slightly above one billion dollars in 2015. Ladenburg Thalmann cites the retirement of nearly 80 million baby boomers and their need to adjust retirement assets accordingly as a potential macro economic trend driving IBD revenues. I think the scale (presence in all 50 states) and independent nature of the company's IBD lines of business give it a flexible advantage in the market.

To Acquire or be Acquired:

Management has strategically expanded the company's nationwide presence and services with a number of key acquisitions. Ladenburg has purchased Securities Service Network, KMS Financial Services, and Highland Capital Brokerage, as well as some assets of Sunset Financial Services over the past few years, in an effort to solidify a foothold in IBD and its more stable cash flows. Based on the successful growth mentioned earlier, this strategy has served the company well.

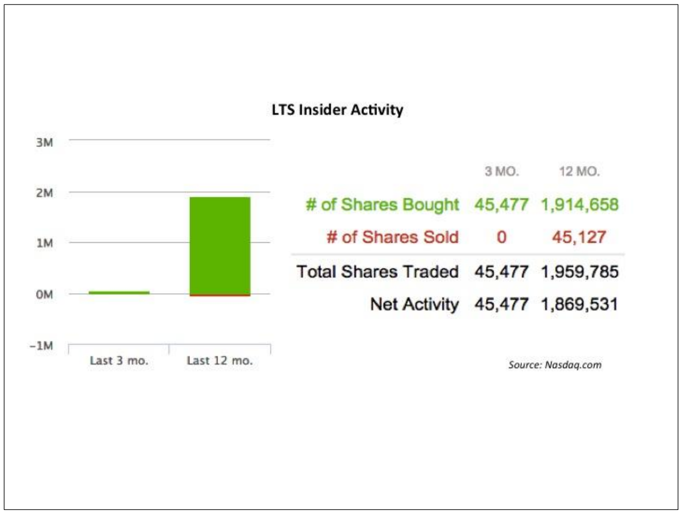
The firm views revenues tied to investment banking, capital markets, institutional sales, and trading as more volatile and subject to business cycles. Ladenburg believes the independent brokerage business can generate significant operating cash flow when its other business units might suffer from downturns and to benefit from its diversification efforts. These recent acquisitions align well with this strategy and have already have had a meaningful impact on revenue. The Highland Capital acquisition also enabled entry into the wholesale life insurance business, yet another avenue to diversify operations.

Given its wide range of products and services, as well as its upward trending revenues, I could see Ladenburg Thalmann sparking the interest of a much larger financial services company like **Raymond James (NYSE: RJF)** which it most closely resembles. Ladenburg is still a relatively small player in terms of market value compared to some of the heavier hitters. The company is financially healthy and has reduced long term debt from almost $200 million in 2012 down to around $56 million at the end of 2014.

Insider Buying & Valuation:

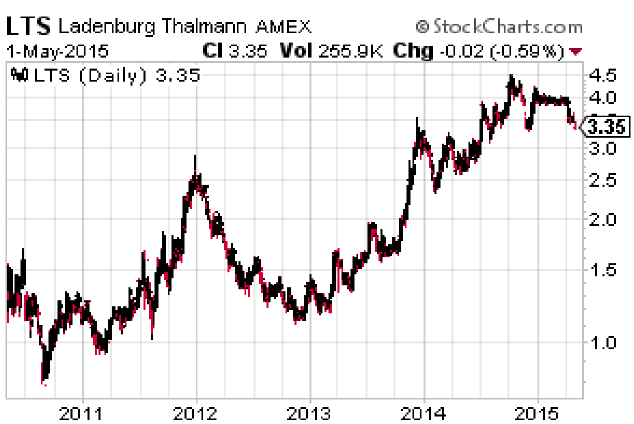
I always like investing along with insiders. Over the past year, almost two million shares of Ladenburg Thalmann have been purchased by insiders. Many of these parties maintain significant investments in the firm. Among them is the aforementioned and renowned billionaire investor Dr. Phillip Frost, who holds over 12 million

Bret Jensen's Small Cap Gems



shares, and CEO Richard Lampen, who holds just over one million shares.

Ladenburg Thalmann is trading at approximately $3.50 a share. The company flirted with the one dollar per share mark in the 2012 before finding traction at the end of 2013 and into the beginning of 2014. I think this upward trend will continue in the coming years outside a significant domestic recession.



Probably the best way to value Ladenburg is to compare some key metrics against competitors in the space like Raymond James which is larger but has similar business lines. Raymond James is currently trading north of 1.5 times forward revenues. Currently, Ladenburg is trading at approximately 60% of this year's expected sales. In addition, Ladenburg's revenue should increase at three times the rate of Raymond James this year. During its last completed quarter, the company grew revenues by slightly over 25% year-over-year. Over time, I expect this large valuation discount to narrow significantly.

Summary:

I like management's strategy of diversifying the firm's revenue base and scaling up IBD operations. I am fine owning Ladenburg as a stand-alone entity as I think revenues will continue to grow at a good pace and it will successfully expand its investment banking business and has scale now in asset management.

The company has made big strides reducing leverage and increasing EBITDA. Adjusted EBITDA should come in between $70 million to $80 million in 2015 in 2015. Ladenburg has a current stock buyback authorization of just over 10 million shares in effect, which would retire over five percent of its outstanding float at current price levels.

I also would not be surprised to see Ladenburg become an acquisition target itself. In February, Stifel Nicolaus acquired Stern Agee. The price paid by Stifel was slightly better than two times Stern Agee's annual revenues. Applying the same metric to Ladenburg would value the company at roughly $10.00 a share. I think this is a very optimistic scenario. However, I can easily see the shares hitting $5.00 to $6.00 in the next 12 to 18 months should the company continue to expand both AUM and its investment banking business.

Recommendation: Buy up to $4.00 a share, hold until $6.00 a share and then re-evaluate.

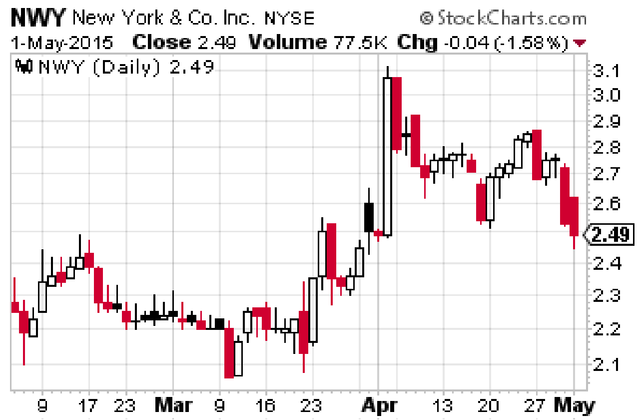
Position: Long LTS

New York & Company

One of the conundrums of the economy and the market right now is the amount of the recent gasoline "tax cut" that is showing up in additional consumer spending. The huge boost in consumer spending that pundits were predicting due to lower gas prices simply has not occurred so far. Consumers are saving some three fourths of that additional cash and the personal savings rate recently hit 5.8%, a multi-year high. Restaurants seem to be getting some additional love from consumers but overall consumer discretionary spending has not seen much of an uplift. However, this should start to change if gasoline prices continue to be lower than they have been in years and job growth remains robust.

With spring finally thawing the Northeast region of the U.S., and low gas prices putting extra cash into the pockets of many Americans, the retail sector could be poised for solid growth and an increase in store traffic. Today I want to talk about a long-term play called **New York & Company (NYSE: NWY)**, which despite an underwhelming fourth quarter performance should experience improvements in a number of its key value drivers in the quarters ahead.

A specialty retailer of women's fashion apparel and accessories, NWY has traditionally targeted wear-to-work apparel for the 25 to 45 year-old demographic. With affordable price points, the firm has solidified its place in the women's professional clothing market. The NPD Group ranked the firm number one in the women's specialty non-denim pant market for the 35 to 45 age group, and number three in the broader 25 to 45 age group. New York & Company intends to transition to a broader lifestyle retailer and utilize an omni-channel approach to generating sales.



NWY is currently trading at around $2.76 a share. I expect management's diversification strategy and efforts to reduce costs will have a positive impact on the firm's financial performance and share price going forward.

Sub-brand Diversification:

The retailer utilizes a number of sub-brands to differentiate itself in the women's apparel industry. NY&C launched Soho Jean in August of 2014 in an effort to expand into the denim market, and created its Love brand to tackle women's active wear. The firm also possesses its 7th Avenue line, which is strongest in jackets, shirts and knit-tops. The company plans to support these via marketing channels that include social, digital, direct mail and e-mail database.

The firm's diversification of its product lines is a wise strategic move because it should help gain market share in new areas and boost revenues over time. The active wear segment in particular holds promise because yoga pants, leggings, and other "athleisure" type products have become a popular modern trend. According to Yahoo Finance!, all five analysts covering NWY are anticipating an increase in revenues in both 2015 and 2016. I am confident that the firm's diversification strategy will pay off and bolster sales going forward.

Omni-Channel Retail Strategy:

Recognizing the dynamic nature of the retail market, New York & Company is implementing a well-rounded approach to increasing customer value. With its traditional NY&C stores, outlet locations, and impressive eCommerce business, the retailer is trying to create a seamless shopping experience for customers across all platforms.

Outlet exclusives have been particularly successful, growing to over 70% of sales compared to 61% in 2013. Outlet exclusives carry a higher margin, and New York & Company should have over 100 of these stores compared to its current 62 locations over the next few years. The firm converted nine NY&C stores to new outlet stores this February, and is open to converting more in the future. I think the company's bullish stance on outlet stores is a good thing, as those locations experienced solid customer traffic and sales growth.

Rounding out New York & Company's omni-channel strategy is its growing eCommerce presence and capability. The firm recently established the ability for customers to purchase clothing online and then pick it up in store, or order clothing while in store and have it delivered. These efforts have helped improve the customer shopping experience and created a seamless transition between brick and mortar stores and the higher margin online shopping.

The eCommerce channel has recently grown to 14% of the company's overall revenues, up from 10% in 2013. NY&C reported significant growth in traffic, conversion and average dollar sale for its online channel earlier in the year. Traffic from those ordering on mobile devices also improved, a crucial aspect in today's smart-phone focused society. I look for further increases in the online channel's contribution to sales in the months ahead.

Eva Mendes Partnership:

New York & Company entered into an agreement in 2013 with the popular American celebrity Eva Mendes to make her the cornerstone of the firm's marketing efforts. The Eva Mendes Collection, an assortment of "desk to dinner" style dresses, has found success and has been received well by customers. The actress and model will star in a television commercials for the company, helping to bolster attention to her product line and the company overall.

NY&C noted a correlation between stores that have a high penetration of Eva Mendes business to a higher level of increased traffic. In the online realm, her product line penetration is in the mid-double digits, and management is seeing her business mix approaching the double-digit mark in some of the top 20 retail locations. The partnership has helped attract customers who are less promotionally driven, and has helped the firm migrate away from the strictly business attire.

Project Excellence and Operating Margin:

Project Excellence is a company wide effort to improve operational efficiency. The company has eliminated and consolidated numerous positions in the corporate office, the firm is expected to save between nine and 10 million dollars in annualized expenses related to the design, merchandising, sourcing and planning functions this year.

NY&C plans to initiate phase two of this initiative, which focuses on the reduction of spending and procurement costs, in the second half of 2015. The company will undertake an analysis of the competitive bid process for corporate and store expenses, hoping to reduce buying costs, product costs and SG&A expense.

If the firm can find cost savings like it did with the corporate realignment then we should see positive movement in its operating margin which currently is at the low end of the retail space and ultimately much better bottom line results.

Waning Headwinds:

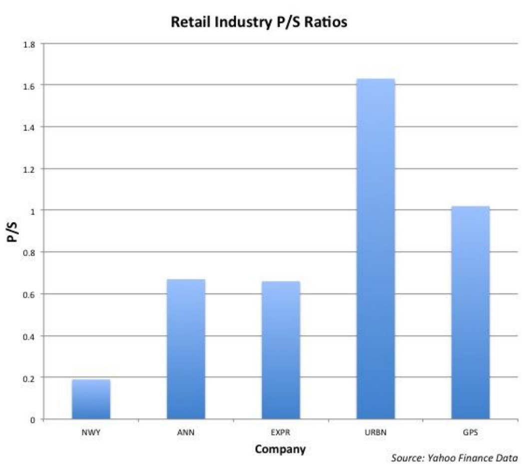
Recent results were impacted by the west coast port strike as well as a brutal winter in the Northeast undoubtedly affected consumer desire to venture out and make discretionary purchases. Now that winter is over store traffic should pick up again.

New York & Company was able to mitigate some of the weather's effects via its online sales capabilities, but I would anticipate an uptick in brick and mortar store traffic now that snowfall is no longer a near weekly occurrence in New England.

Valuation & Coverage:

New York & Company has a sizeable amount of cash and cash equivalents compared to its market capitalization. The retailer has a market capitalization of approximately $175 million currently. The firm has a very solid balance sheet which holds about $70 million in cash. With cash on hand equating to almost 40 percent of its market cap, the company has the financial flexibility to continue to improve its business. Once it turns the corner, some of this excess cash could find its ways into stock buybacks and maybe even a dividend.

New York & Company's price to sales ratio is one of the lowest in retail at under 20%. Two of its peers, Ann Inc. and Express Inc. are valued at approximately two thirds of annual revenues. If NY&C is successful at improving its margins investors should reward it with a sales multiple more in line with peers.



Brean Capital recently initiated coverage on New York & Company with a "Buy" rating. The analyst cited the end of port issues and real estate optimization related to the closure of 150 underperforming stores as favorable factors in her analysis. Brean also lauded the strength of the retail company's sub-brand, omni and outlet initiatives while remaining positive that direct to consumer online efforts could offer margin growth potential.

I like Brean Capital's analysis of New York & Company and agree that the firm is taking steps in the right direction to shore up any weaknesses. Over the past twelve months, insiders have purchased a net of about 234,000 shares of NWY, indicating that those who know the company best are bullish on its future performance. I think the firm is a solid long-term play in the retail sector and will look for share price appreciation on improved revenues and higher margins.

We will be watching closely to see if the company can put its recent challenges behind it. It should benefit as the economy accelerates in the second half of the year and as consumers start to spend more of their gasoline savings and the company's initiatives to improve margins bear fruit.

Recommendation: Buy NWY up to $3.00 a share, we will re-evaluate company's performance six months from now heading into the holiday season; hopefully at a significantly higher stock level.

Position: Long NWY

Portfolio Update

Despite a flat performance from the Russell 2000 in April and somewhat of a pullback in the biotech space late in the month, we saw some decent performance from several names in the Small Cap Gems portfolio over the past thirty days.

Eagle Pharmaceuticals (NASDAQ: ERGX) continues to be the star of the current portfolio. Even with a recent pull back, the stock posted another huge month and is up around 300% since inclusion into the portfolio during December. **Agenus (NASDAQ: AGEN)** is another emerging big biotech star within our portfolio. The shares were powered this month as its adjuvant used within a Shingles vaccine developed GlaxoSmithKline (NYSE: GSK) showed stellar Phase III trial results and should be on the market within the next 12 months.

This is a good time to remind subscribers of my philosophy about culling winners in high beta areas like small caps and biotech stocks. That is to take 10% off the table after a 50% share price gain, another 20% of original stake should cashed after the equity doubles. If one is fortunate enough to see their position tripled, another 20% of original stake should be sold. The remaining half of your position is now playing on the “house’s” money and you have already booked a guaranteed profit. Anyone who invested near the prices these two stocks were recommended at should have cashed out 50% of their stake in Eagle and 30% of their original position in Agenus.

As mentioned in the beginning of this month’s issue, the personal savings rate has shot up to 5.8% as consumers are banking most of their gasoline “tax cut” at the moment. Provided gasoline prices stay at recent lower levels, consumers should eventually move more of those savings into increased consumer spending. Our retail plays, **RCI Hospitality Holdings (NASDAQ: RICK)**, **Summer Infant (NASDAQ: SUMR)** and **Big Five Sporting Goods (NASDAQ: BGFV)** all showing solid performance in April perhaps foreshadowing that event. Big Five was also helped by quarterly results that easily beat top and bottom line expectations.

We are still waiting for our home building plays to start to move upward. However, there are some encouraging signs recently. Pending home sales just saw their best readings since June 2013. **UCP Inc. (NYSE: UCP)** also had a late month move. Helping this rise was that D.R. Horton (NYSE: DRI) bought a small Seattle homebuilder in the last week for a price that suggests UCP's lot inventory in the Emerald City is significantly undervalued.

I expect to see some increased volatility in the market until we get some confirmation that the economy will recover from a dismal first quarter and that earnings for the S&P 500 will start to show positive year-over-year growth starting in the second half of the year. I also believe our portfolio is well positioned to benefit from strengthening consumer sentiment and stronger job growth in the months ahead.

As always, if you have questions about any of our portfolio holdings just send me an email at bret.jensen@investorsalley.com.

Bret Jensen's Small Cap Gems

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Target Price	Returns	Russell 2000 Comp. Rtn.
New York & Company (NWY)	04/29/15	$2.76	$2.49	$3.00			
Ladenberg Thalman Financial (LTS)	04/29/15	$3.46	$3.35	$3.35			
Endocyte (ECYT)	03/31/15	$6.26	$5.80	$7.00		-7.3%	-1.9%
LGI Homes (LGIH)	03/31/15	$16.66	$16.47	$18.00	$30.00	-1.1%	-1.9%
Great Lakes Dredge & Dock (GLDD)	02/27/15	$6.10	$5.77	$6.75	$9.00	-5.4%	-0.4%
Threshold (THLD)	02/27/15	$4.37	$3.52	$5.00	N/A	-19.5%	-0.4%
Mastec (MTZ)	01/30/15	$18.52	$18.08	$21.00	$30.00	-2.4%	5.4%
Eagle Pharmaceuticals (EGRX)	12/30/14	$14.20	$52.70	$15.00	$30.00	271.1%	1.2%
OncoGenex Pharmaceuticals (OGXI)	12/30/14	$2.23	$1.97	$2.50	$5.00	-11.7%	1.2%
Summer Infant (SUMR)	12/30/14	$3.33	$3.09	$3.50	$5.00	-7.2%	1.2%
Agenus Inc. (AGEN)	11/28/14	$2.96	$6.85	$3.50	$9.00	131.4%	4.7%
Progenics Pharmaceuticals (PGNX)	10/30/14	$4.86	$5.24	$6.00	$14.00	7.8%	6.3%
Conatus Pharmaceuticals (CNAT)	10/30/14	$7.55	$5.95	$8.50	$15.00	-21.2%	6.3%
Abraxas Petroleum (AXAS)	09/30/14	$5.28	$3.69	$6.00	$10.00	-30.1%	11.5%
Tutor Perini (TPC)	09/30/14	$24.60	$21.47	$30.00	$44.00	-12.7%	11.5%
Beazer Homes USA (BZH)	08/29/14	$18.85	$18.05	$20.00	$40.00	-4.2%	4.6%
UCP (UCP)	07/30/14	$13.00	$8.66	$14.00	$20.00	-33.4%	7.1%
Walter Investment Mgmt. (WAC)	07/18/14	$27.27	$17.59	$35.00	$60.00	-35.5%	6.6%
RCI Hospitality Holdings (RICK)	07/18/14	$11.23	$11.30	$12.00	$25.00	0.6%	6.6%
Big 5 Sporting Goods (BGFV)	07/18/14	$11.51	$13.69	$13.00	$17.00	18.9%	6.6%

Closed Positions

Company	Entry Date	Entry Price	Close Price	Close Date	Return
Sonus Networks (SONS)	08/29/14	$18.85	$7.88	03/31/15	-58.2%
American Eagle Energy (AMZG)	07/30/14	$6.36	$0.18	03/31/15	-96.7%
Avanir Pharmaceuticals (AVNR)	07/18/14	$5.39	$16.96	12/05/14	214.7%

Notes:

Entry price is determined by the last "Close" price at the closing of the market on the day before publication. Recent price is determined by the last "Close" price at the closing of the market on the day before publication; most recent update: 04/30/15. Returns is share price appreciation or depreciation between entry price and recent price. Russell 2000 Comp. Rtn. represents the returns on the Russell 2000 Index from the point of entry of a stock listed above through the recent price and is meant to provide a comparison to the overall small cap stock market as comprises that index.

*SONS entry price based on 01/30/15 1 to 5 split.

This is not real-time data and should not be interpreted as such.