

Back-Alley Investing

Trafficking in “teeny-weeny” companies is in many ways investing at its most basic level, says Paul Sonkin, one of the art’s most accomplished practitioners.

Paul Sonkin doesn't consider himself spread too thin in keeping close track of the 100-position portfolio of exceedingly small-cap companies he owns. “An IBM or a Disney can have a single footnote longer than a lot of the entire annual reports I look at,” he says.

Sonkin's investment performance certainly wouldn't indicate that he's over-taxed. Since launching his Hummingbird Value Fund at the end of 1999, he's earned a net annualized return of 7.8%, vs. 3.5% for the Russell 2000.

Today's microcap market is offering “the best opportunity to put capital to work since 2002,” he says, and he's doing just that in such varied industries as freight shipping, timber, fractional jet ownership, IT consulting and videogames. [See page 2](#)

INVESTOR INSIGHT



Paul Sonkin
Hummingbird Value Funds

Investment Focus: Seeks companies so far off the beaten path that their assets or potential earnings power are being dramatically undervalued by the market.

Inside this Issue

FEATURES

Investor Insight: Donald Yackman

Finding unrecognized value in highly recognizable names such as News Corp., PepsiCo, Coca-Cola, Viacom and Comcast. [PAGE 1 »](#)

Investor Insight: Paul Sonkin

Finding upside at the bottom of the market-cap food chain in Rand Logistics, Keweenaw Land, Avantair and SouthPeak Interactive. [PAGE 1 »](#)

A Fresh Look

Investors have seen many of their carefully selected positions plunge in value in the past year. How Brian Bares has handled one such position. [PAGE 16 »](#)

Uncovering Value: Staples

“Competitive destruction” can greatly benefit incumbent leaders. Here’s a potential case in point. [PAGE 17 »](#)

Editors’ Letter

On the common trait shared by top performers in any field. [PAGE 18 »](#)



INVESTMENT HIGHLIGHTS

INVESTMENT SNAPSHOTS	PAGE
Avantair	12
Comcast	8
Corporate Executive Board	16
Keweenaw Land	13
News Corp.	4
PepsiCo	6
Rand Logistics	11
SouthPeak Interactive	14
Staples	17
Viacom	5

Other companies in this issue:

[AmeriCredit](#), [Coca-Cola](#), [Edgewater Technology](#), [Greenlight Capital Re](#), [International Assets Holding](#), [Office Depot](#), [OfficeMax](#), [Scope Industries](#), [The Bancorp](#), [Winmark](#)

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Hummingbird Value Fund, LP

Tarsier Nanocap Value Fund, LP

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Investor Insight: Paul Sonkin

Hummingbird Value Funds' Paul Sonkin explains why he's unlikely to ever move up the market-cap food chain, how he's set up his own customized research service, why he doesn't consider himself at all overtaxed in tracking 100 positions at a time, and why he thinks Rand Logistics, Avantair, Keweenaw Land and SouthPeak Interactive are mispriced.

There are small caps and then there are *really* small caps like the ones you buy. How did you arrive at that strategy?

Paul Sonkin: In my second year at Columbia I took Bruce Greenwald's value investing class, and on the first day he showed us a table from Eugene Fama and Kenneth French's famous *Journal of Finance* paper called "The Cross-Section of Expected Stock Returns." The table showed how low-price-to-book stocks and small caps tended over long periods of time to outperform the market as a whole. The whole idea made so much sense to me that I decided that was the basic direction I wanted to go.

In that same class, I was working on a paper that was inspired by an article I'd read in *Barron's* that talked about a pink-sheet company called Park Lexington, which happened to be based in New York between Park and Lexington avenues. They owned three residential buildings in and around the city and I started to put together a research report, but had so many questions that I called one of the investors mentioned in the *Barron's* article, Ed McLaughlin, and he suggested the two of us go together to speak with the company. We had no trouble getting answers to our questions and Ed ended up sending my final report to the company's board, which reviewed it. It may have just been a coincidence, but they ended up going private six months later.

I thought, "Wow, you can pick up the phone and talk to these people and maybe have some influence on what they do." That seemed much more interesting to me than holing up at a desk somewhere and poring through the footnotes in GE's 10-K.

Describe your opportunity set.

PS: There are something like 30,000 securities that trade primarily over-the-count-

er through the pink sheets, an electronic quotation system that displays quotes from broker/dealers. Of that number, maybe 40% are so obscure that they rarely, if ever, have a bid or offer. A much smaller subset are foreign ADRs, for companies like Nestle or Danone that don't want to report financials using U.S. accounting principles.

Where we're active is in the remaining companies, which are either old-school pink-sheet holdovers like Ash Grove Cement or Boston Sand & Gravel, or newcomers to the pink sheets that, because of the expense or hassle of being public have decided to "go dark" and stop filing 10-Ks and 10-Qs with the SEC. They can do that if they have fewer than 300 shareholders. Our contention is that there's no better place to look for inefficiently priced securities than in those of unfollowed, unwanted and unloved companies. We call it combing through the back alleys of Wall Street for garbage people have thrown away. That's how you can find small, obscure companies trading at 2-3 times earnings.

You'd be amazed at the offbeat companies that exist out there. One stock we own is Scope Industries [SCPJ], which has been around for 70 years and basically takes stale bread and turns it into what it calls "dried bakery product" that gets put into animal feed. About five years ago they sold off a business running beauty schools, and they've been quite smart about allocating capital as they've developed the cattle-feed business. They pay dividends. They buy back stock. They make accretive acquisitions.

Until just a couple days ago, the stock traded at around \$120 per share, which translated into an enterprise value (after \$23 million of net debt) of \$87 million. This for a company that earned \$18.5 million of operating income in the fiscal year ending in June, which was down



Paul Sonkin

Getting Serious

Paul Sonkin's first exposure to the investment business came through an uncle who was a successful broker at Smith Barney. "As a teenager, I thought it looked like great fun," Sonkin says. "I remember thinking all he did was talk to people on the phone, tell jokes and play a lot of golf."

Sonkin got serious about investing at Columbia Business School, graduating with an MBA in 1995 and then serving stints at Royce & Associates and First Manhattan before striking out on his own – with seed money from famed Columbia alum Mario Gabelli – in 1999.

Sonkin's ties to Columbia have remained deep. In 2001 he was one of the co-authors, led by Columbia Professor Bruce Greenwald, of the highly regarded *Value Investing: From Graham to Buffett and Beyond*. He still serves as an adjunct professor at the business school, where he teaches courses on security analysis and value investing. Does the good professor have another book in him? "I've thought a lot about the basic criteria for an ideal investment idea, and could see writing a book around that one day," he says. "At the moment, though, I've just got too much else to do."

from more than \$27 million the year before. We thought the stock was quite cheap, given that the profit decline was likely just a cyclical pricing issue and not the result of anything fundamental. While I can't say I know exactly why, the stock rose 33% on the day before Thanksgiving.

I don't want to give the impression that only the oddball companies can be bargain-priced. We just met recently with Edgewater Technology [EDGW], an IT consulting company in which we have a starter position. The CEO is very impressive and we think the company has normalized earnings power of \$5-6 million, post recession. Against that you have a market cap of \$34 million, which net of cash is only \$12 million. Those are the types of valuations you can find in companies like this.

Where do your ideas come from?

PS: I like to have information pushed at me, so I've set up keyword alerts on something like 3,000 companies, which results in 20-25 press releases a day announcing things like management changes, reorganizations or new dividends. Ideas come out of that all the time.

Another thing I've done in my personal account is to buy one share of probably 250 companies, which is kind of my own customized research service. The daily mail delivery is kind of a Christmas grab bag – you never know when an annual or quarterly that arrives is going to catch your eye. Scope Industries' 2009 annual report showing up in the mail, for example, led me to take a closer look at it and I ended up buying the stock.

One last thing I'd mention as an idea generator is tracking new-lows lists. I always say margins of safety are created out of broken dreams, and there's a fresh list of those broken dreams published daily for us to hunt through.

Describe the general composition of your portfolio – we imagine you have to own a lot of these little companies at a time.

PS: Concentration and micro caps don't mix all that well, so we typically own

around 100 names, with a big position being 3-4% of the portfolio. Tiny companies are by definition more vulnerable to catastrophe if something goes wrong, so we try to limit the potential damage from that by owning a lot of them.

I've had people ask if we're spreading ourselves too thin by owning so many positions at a time. What I answer is that there's an enormous difference in the effort required to follow a big company than a small company. I'd argue that a portfolio of 20 large-cap companies, each

ON ILLIQUIDITY:

Illiquidity today is a dirty word, but we believe we're being paid more than handsomely to assume liquidity risk.

of which is in five or six distinct businesses, is more difficult to keep track of than 100 small companies that typically operate in a single niche. An IBM or a Disney can have a single footnote longer than a lot of the entire annual reports I look at.

How important to you is interaction with management?

PS: In our larger holdings we will have done a lot of due diligence and expect to know management and need to be impressed with them. In our smaller positions contact with management is less important – we're buying into the business mostly because it's statistically cheap. The financials and whatever other communication exists can generally give us a good sense of how shareholder friendly those companies are.

I'd add that while it takes a lot less time to cover a micro-cap company, the potential value added by the research is substantially greater. I have a lot less competition. I'm also much more able to speak directly with the CFO or CEO, who may not be as polished in the ways of Wall Street and might be more open and forthcoming about their business. All of that makes it easier to uncover new

and previously unknown facts, which can be an important edge.

Is portfolio volatility a killer for you?

PS: While individual positions can obviously be volatile, over a diversified portfolio we've found that a lot of that volatility goes away.

When I worked for Chuck Royce he had me working on the technology sector, where you really learn that volatility can be your friend. I have a section in my original Hummingbird strategy paper that compares the stock charts of a proverbial "drill-bit" company, which happened to be Federal Signal, and a technology company we've owned over time called Simpletech. Over the period or three or four years we looked at, Simpletech went from \$10 to \$1 to \$10 to \$2 to \$10 again, while Federal Signal oscillated between \$15 and \$25. We're hardly day trading in our stocks, but volatility is what gives us opportunities to buy low and sell high.

How would you characterize the appetite for micro caps today?

PS: There's quite a bit of evidence that investors (and speculators) have pulled way back from smallest micro caps like the ones we buy. Trading volume has dried up and bid-ask spreads can be huge – in many cases the offer is 100% above the bid. Not terribly surprising after the crisis, illiquidity is a dirty word.

We actually believe that's given us the best opportunity to put capital to work since 2002. People today are so obsessed with liquidity that the premiums being paid for it are very high. Since we're long-term investors, we believe we're being paid more than handsomely to purchase illiquid securities and assume the liquidity risk.

Let's talk about some of the best opportunities you're finding, starting with Rand Logistics [RLOG].

PS: Rand owns a fleet of 13 bulk carriers that provide freight shipping services in the Great Lakes. They focus on river-class

vessels, which are somewhat smaller and can navigate a lot of the twists and turns you find on the lakes. The cargo mix is primarily stone, grain and salt, serving a blue-chip customer base – including Anheuser-Busch, Archer Daniels Midland, Georgia-Pacific and Cleveland-Cliffs – with mostly long-term contracts.

This is a case where we're betting on the jockey as well as the horse. The CEO and President, Laurence Levy and Edward Levy (who aren't related), know how to make money and have a history of doing so in companies with hard assets that also generate a lot of cash flow. They're not particularly promotional and

don't always communicate with investors that well, but I'll take substance over style any day.

The business is protected in a couple of structural ways. The first is that both Canada and the U.S. have laws – the Jones Act in the U.S. and the Canadian Marine Act in Canada – that prevent foreign-built ships or foreign crews from operating in this region, and the process for getting approval to operate is onerous and drawn-out. The number of boats on the Great Lakes is actually going down, as older boats get taken out of service faster than new boats are added. That gives Rand more upside on raising prices

without losing business, so they've been getting 5-6% price increases as they roll over contracts.

The company also has a structural cost advantage, which is a function of the types of boats they own and the favorable union contracts they have. They can staff their ships with 20-30% fewer people than competitors typically have to use, while still meeting the U.S. Coast Guard's minimum requirements.

How economically sensitive is the Great Lakes shipping business?

PS: Volume goes up and down, but Rand's cargo tends to be somewhat less economically sensitive. Through July of this year, the company cited numbers showing that overall tonnage of iron ore on the Great Lakes was down 50% over the five-year average, limestone was down 46%, and coal was down 22%. But Rand's overall sales were down less than 10%. One big reason for that is that in tough times they pick up incremental business because their rates per ton are lower than the competition's – not just lower than other shippers, but also compared to shipping by rail or truck.

Longer-term we consider continually strong trade between the U.S. and Canada as a secular tailwind for Rand. It will also be a big beneficiary – because of all the basic materials and aggregates it ships – if there's the big investment in road, bridge and tunnel infrastructure that people are expecting.

How inexpensive do you consider the shares, now trading around \$3.10?

PS: We expect the company to earn around \$7 million in EBITDA for the year ending in March 2010, and we consider normalized earnings as they emerge from the recession to be closer to \$12 million. There are 13 million shares outstanding, so that's over 50 cents per share in current cash flow and over 90 cents per share based on where we think the business will be in a couple years. So on a current basis the shares trade at less than 6x cash flow, and on a normalized basis it's only 3.4x.

INVESTMENT SNAPSHOT

Rand Logistics
(Nasdaq: RLOG)

Business: Provider of bulk freight shipping services primarily for the transport of coal, stone, salt and grain in the Great Lakes region, serving U.S. and Canadian ports.

Share Information
(@11/27/09):

Price	3.10
52-Week Range	2.02 - 4.55
Dividend Yield	0.0%
Market Cap	\$40.5 million

Financials (TTM):

Revenue	\$104.0 million
Operating Profit Margin	5.3%
Net Profit Margin	(-6.6%)

Valuation Metrics

(@11/27/09):

	RLOG	Nasdaq
Trailing P/E	n/a	44.0
Forward P/E Est.	7.7	19.9

Largest Institutional Owners

(@9/30/09):

Company	% Owned
David M. Knott	20.9%
Ramius LLC	14.0%
Rutabaga Capital	9.7%
MHR Fund Mgmt	3.5%
Robeco Inv Mgmt	1.4%

Short Interest (as of 11/13/09):

Shares Short/Float	n/a
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RLOG PRICE HISTORY



THE BOTTOM LINE

The company's structural and cost-related competitive advantages have helped it limit damage from the economic downturn and position it well to benefit as bulk-shipping traffic on the Great Lakes eventually improves, says Paul Sonkin. The shares currently trade at only 3.4x his normalized 90-cent-per-share estimate of annual EBITDA.

Sources: Company reports, Hummingbird Value Funds, other publicly available information

What are the biggest risks?

PS: Given where we are in the cycle, we don't see a lot of downside risk to the business. In terms of asset protection, current shareholders' equity, which we think is real, is just over \$3.50 per share. Just doing a quick calculation, they could probably sell off their fleet for something close to \$130 million, which after paying off debt and preferred-stock holders, would leave them with cash equal to the current share price.

In many cases I might worry about the company making dumb acquisitions, but that's not the case here. Management has made accretive acquisitions of vessels in the past at very low EBITDA multiples. With Rand's physical and operational infrastructure in place, new-vessel revenues are very profitable and the addition of capacity can make the company even more efficient in the scheduling and loading of its ships.

Describe your interest in Avantair [AAIR], which is sort of a mini-NetJets.

PS: Like NetJets, Avantair is in the fractional-aircraft business. They own a homogenous fleet of about 55 Piaggio Avanti planes, which are turboprops manufactured by Piaggio, an Italian company that has been around for more than 70 years. The plane looks like it's flying backwards because the propellers are in the rear instead of the front, which allows for a much larger cabin – you get the cabin of a \$14 million aircraft in a plane that costs only \$6 million. The Avantis operate at considerably less cost than a comparable plane like the Hawker 400 jet, which uses roughly twice as much fuel per mile flown. Avantair has the exclusive right to sell fractional shares of the Avanti in the U.S.

How is Avantair's business model supposed to work?

PS: The company buys the planes for \$5 million each and then sells them off in 16 fractional shares for a total of \$6 million. They also charge a \$10,000-per-month

flat fee for maintenance and service, for which a fractional owner gets 50 hours of flight time per year at no additional cost. On the maintenance and service revenue they earn an operating margin of around 25%, which comes out to \$480,000 in incremental margin per plane per year falling to the bottom line.

One important difference between Avantair and NetJets is that NetJets doesn't have a homogeneous fleet. If a certain size plane isn't available when a customer needs it, NetJets may have to provide the customer with a plane that's more expensive to operate, without getting paid any extra for doing so.

We assume scale economies matter – is Avantair big enough to make it all work?

PS: They're at an inflection point. Once they hit 40-45 planes, they can maintain and operate the fleet more efficiently, which makes the economics of the business model kick in. EBITDA first turned positive in the quarter ending last December and in the most recent quarter, ending September 30th, EBITDA was \$1.7 million.

Because they're so much less expensive, Avantair is actually growing fairly nicely through the recession. Fractional ownership in one of its planes costs

INVESTMENT SNAPSHOT

Avantair
(OTC: AAIR)

Business: Sale and management of fractional ownership interests in and charter usage of professionally piloted aircraft for private and business use in North America.

Share Information

(@11/27/09):

Price	1.59
52-Week Range	0.41 - 2.30
Dividend Yield	0.0%
Market Cap	\$45.5 million

Financials (TTM):

Revenue	\$136.8 million
Operating Profit Margin	0.1%
Net Profit Margin	(-3.3%)

Valuation Metrics

(@11/27/09):

	AAIR	Nasdaq
Trailing P/E	n/a	44.0
Forward P/E Est.	n/a	19.9

Largest Institutional Owners

(@9/30/09):

Company	% Owned
AWM Inv	22.1%
Jonathan Auerbach	10.9%
Potomac Capital Mgmt	6.5%
Paul D. Sonkin	6.4%
Gilder Gagnon Howe	5.8%

Short Interest (as of 11/13/09):

Shares Short/Float	n/a
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AAIR PRICE HISTORY



THE BOTTOM LINE

With the economics of its business model "kicking in" as it grows, Paul Sonkin believes the company can earn at least \$20 million in annual EBITDA once the economy starts to fully mend. Against today's market cap of only \$45 million, he says, "You're paying a tiny multiple of earnings power for what is kind of a sexy growth business."

Sources: Company reports, Capital IQ, Hummingbird Value Funds, other publicly available information

roughly half what a comparable plane would cost with NetJets. It's recession chic – if you're going to buy into a private plane, this is a great way to do it.

Even if people are hesitant to commit to buying a full share, Avantair has been successful selling flight time by the hour through what they call their Axis Club. The revenue per hour on those sales is quite attractive, and what should happen over time is that the Axis Club members eventually buy full plane shares.

With the shares now around \$1.60, how are you looking at valuation?

PS: Once the economy improves, we believe they can reach their goal of selling an additional 12 planes per year. That generates \$12 million in additional free cash flow. On top of that would be the \$480,000 in cash flow per plane from the maintenance and service fees, which adds another nearly \$6 million per year. So within the next couple of years we think the company can be earning at least \$20 million in EBITDA per year, against a current market value of only \$45 million. Based on the earnings power of the business, you're paying only a tiny multiple of EBITDA for what is kind of a sexy growth business.

Is the company well financed?

PS: They shored up their balance sheet and reduced annual interest costs substantially through a recent PIPE [Private Investment in Public Equity] offering. One of the lead investors in the PIPE was Special Situations Funds, run by David Greenhouse and Austin Marxe, who we consider very smart micro-cap investors. Other shareholders whom we respect include Jonathan Auerbach of Hound Partners (one of my former students at Columbia) and David Knott. We also think the company's board – which includes people like Clint Allen, one of the founders of Blockbuster, and Bob Lepofsky, the current CEO of Brooks Automation – is first-rate.

We're looking for companies like Avantair that can execute even in a tepid economic environment. That it's holding

up well through such a lousy economy gives us that much more confidence in its prospects when things finally turn up.

What's the investment thesis for Keweenaw Land [KEWL], a veritable mega-cap stock for you?

PS: This is one of those pink-sheet companies that has been around forever. It's basically a timber company with over 151,500 acres of productive timberland in Michigan. In addition, it owns mineral rights to over 400,000 acres of land and has the potential to realize value from wind-power generation, conservation

easements, carbon credits and recreational-use development.

The company is controlled by a wealthy family that has owned it for generations and hasn't been particularly shareholder friendly over that time. To their credit, they provide detailed financials on a quarterly basis and also have a full independent valuation of the company's assets done every three years or so. As is typical of a pink-sheet company with large family ownership and no apparent catalyst, it trades at a huge discount to our estimate of its net asset value.

We got interested when one of our market makers who turned activist

INVESTMENT SNAPSHOT

Keweenaw Land
(Pink Sheets: KEWL)

Business: Ownership and management of timberlands, mineral rights and other commercial and recreational real estate assets located in Michigan's upper peninsula.

Share Information
(@11/27/09):

Price	165.00
52-Week Range	120.00 – 210.00
Dividend Yield	0.0%
Market Cap	\$106.3 million

Financials (TTM):

Revenue	\$9.5 million
Operating Profit Margin	n/a
Net Profit Margin	7.7%

Valuation Metrics

(@11/27/09):

	KEWL	Nasdaq
Trailing P/E	144.7	44.0
Forward P/E Est.	n/a	19.9

Largest Institutional Owners

(@9/30/09):

Company	% Owned
Everett Harris & Co	4.4%
Boston Private Asset Mgmt	1.1%
Boston Family Office, LLC	1.0%
Butler Wick & Co	0.3%
Grace & White	0.2%

Short Interest (as of 11/13/09):

Shares Short/Float	n/a
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KEWL PRICE HISTORY



THE BOTTOM LINE

The company doesn't have a history of shareholder friendliness, says Paul Sonkin, but he believes an activist investor will make headway in unlocking what Sonkin believes is a total asset value of more than twice the current market value. While he waits, he expects the main underlying asset, timber, to continue to appreciate in value.

Sources: Company reports, Capital IQ, other publicly available information

investor, Ronald Gutstein, bought into Keweenaw and started pushing for change. He's had modest success so far, including getting the company to buy back a little bit of stock and sign a contract to explore how to capitalize on the mineral rights. We don't expect the value here to be realized overnight, but the potential upside is big enough that it will pay to be patient.

Walk through how you're valuing the assets, at a time when the shares trade around \$165.

PS: We've tried to layer conservative assumption on top of conservative assumption, using comparable market sale prices and by haircutting estimates from the company and from Ron Gutstein, the activist investor. On a per share basis, we estimate the standing timber value at just over \$200, with the bare land adding another \$105. Commercial, recreational and other development could be worth another \$27 per share, while we're valuing mineral rights at about \$18-19 per share. Assuming nothing for wind power or carbon credits, we put the net asset value at a minimum of \$350 per share.

The biggest risk with this particular investment is that it's dead money for too long. If we realize our estimated value in two years, it's a homerun. If it takes five years, we'll realize a nice 15% compounded return. If it takes 10 years, we've got a not-so-spectacular 7% return. What gives us comfort in being patient is that our assumptions are very conservative and that the main asset, timber, should only become more valuable as time goes on. In fact, timber would do quite well in an inflationary environment, if that comes to pass.

In any activist situation we usually count on what's called the Hawthorne Effect to play a role. The Hawthorne Effect basically says that subjects improve an aspect of their behavior being experimentally measured simply because of the fact that they're being studied. Last year when the activist in Keweenaw waged a proxy fight, he didn't get enough votes to

change the board slate, but he did get enough to send a strong message to the company that they couldn't just sit there and do nothing. We don't believe the activist is going away, and we think the company – which has already responded somewhat – will continue to take steps in response to his watching them so closely.

From timberland to videogames, explain why you see upside in SouthPeak Interactive [SOPK].

PS: The company went public in early 2008 through a reverse merger with a publicly traded SPAC [special-purpose

acquisition company] called Global Services Partners. They are basically value investors in the videogame business, buying rights to games from companies that have little expertise in marketing and distribution, or games that are half-done when the company that owns them runs out of money.

Say a foreign government wants to promote technology and gives a company \$5 million to produce a videogame. SouthPeak might invest along side the government and get the rights to sell the game. It's a publisher and a distributor – without its own studios and the heavy investment that requires – trying to hit

INVESTMENT SNAPSHOT

SouthPeak Interactive
(OTC: SOPK)

Business: Global developer and marketer of interactive entertainment software covering all major game genres and for use on all current videogame platforms.

Share Information
(@11/27/09):

Price	0.29
52-Week Range	0.27 - 2.25
Dividend Yield	0.0%
Market Cap	\$13.1 million

Financials (TTM):

Revenue	\$55.6 million
Operating Profit Margin	(-13.1%)
Net Profit Margin	(-17.9%)

Valuation Metrics

(@11/27/09):

	SOPK	Nasdaq
Trailing P/E	n/a	44.0
Forward P/E Est.	n/a	19.9

Largest Owners

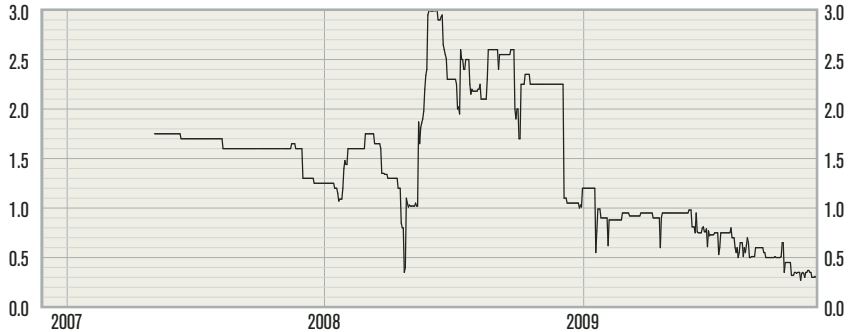
(@9/30/09):

Company	% Owned
Terry M. Phillips	38.1%
Gregory R. Phillips	23.3%
Melanie Mroz	7.1%
Kathleen L. Morgan	6.8%
Hummingbird Mgmt	6.1%

Short Interest (as of 11/13/09):

Shares Short/Float	n/a
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SOPK PRICE HISTORY



THE BOTTOM LINE

Having spent heavily to develop its product pipeline and build out its marketing and distribution capabilities, the company is poised to benefit from an increased number of videogame launches and generate \$8 million in EBITDA within a year or two, says Paul Sonkin. If he's right, he says, today's \$13 million market value looks like a steal.

Sources: Company reports, Capital IQ, other publicly available information

singles and doubles rather than swinging for the fences. It has consistently demonstrated that it can break even on game unit sales of 30,000 to 40,000, which is very little in this business.

There are no insurmountable barriers to entry protecting this company from competitors, but it takes time and effort to develop the strong relationships SouthPeak has with independent producers, with console manufacturers, and with retailers, who are eager to stock a large number of titles in order to drive store traffic. Terry Phillips, who bought the company out of SAS Institute in 2000, has been a successful and well-known player in the industry for a long time.

The company's financial results don't appear stellar and the stock is down 70% so far this year, to around 30 cents. Why?

PS: They've been spending money in developing their pipeline and in building out their marketing and distribution capabilities in advance of increased game launches. Many of those new games are just starting to hit the market, which resulted in revenue growth in the just-finished quarter of 100%. They also wrote off a decent amount of goodwill in the fourth quarter of last year, which made the profits look particularly bad.

One big problem for the stock has been that one early executive of the company left and has been dumping her shares in the open market. That can have a big effect in such thinly traded stocks, but in our view it's not an effect tied to the fundamental health of the business.

We believe the company as early as next year can generate \$100 million in annual revenue, on which they should be able to earn an EBITDA margin of at least 8%. With today's market cap of \$13 million, that means the shares trade at less than 2x normalized EBITDA. For a company with a unique niche in an industry with substantial long-term growth ahead of it, we think that's an extremely good deal.

ON MISTAKES:

They've been in companies where a bunch of little things went wrong. One lesson: Don't ignore minor setbacks.

One thing to point out with tiny companies is that you have to primarily count on the earnings produced to drive the share price. It's great if the market takes note and decides to pay more for those earnings, but you can't count on that.

Speaking generally again, does selling tend to be a challenge for you?

PS: It's typically not that difficult – we're just very patient until we get our price. When we're right about something, we can usually find a fairly ready buyer in the company itself. These companies are often not that interested in being public anyway, so they're often open to buying back stock.

More generally, a frequent catalyst in realizing value in these investments is when someone – often the management – recognizes the same opportunity we do and pays a premium to take the whole company private.

Any insights from your mistakes you'd like to share?

PS: There's an interesting section in *Outliers*, by Malcolm Gladwell, in which he describes how disasters like plane crashes or the Three Mile Island nuclear accident are rarely because of one big mistake. They're more likely to result from a series of small mistakes, any one of which, if avoided, would have kept the disaster from happening. Many investing mistakes we've made have been in companies where a bunch of little things went wrong, which when added together made a big problem. Those types of situations can creep up on you, so I'd say one lesson is to not ignore minor setbacks and to be very aware if they start to pile up.

Can you imagine ever moving up the market-cap food chain?

PS: No, which may keep me from ever becoming fabulously wealthy, because I'm never going to run \$1 billion while sticking with these teeny-weeny companies. That suits me, because I much prefer managing a portfolio to managing the staff I'd need with a lot more assets. Most important, though, is that I just love the thrill of the hunt involved with these types of companies. Why give that up? **VII**