Marcus Frampton, CFA, CAIA, FRM **4/20/2020** Edition 1

THE MICRO CAP & OTC STOCK LETTER

INAUGURAL EDITION

I would like to start this inaugural edition of *The Micro Cap & OTC Stock Letter* with a sincere thank you to all my friends and business contacts who expressed interest in receiving this newsletter. As my professional career has evolved to involve less analysis of individual securities I've increasingly felt the desire and need to stay sharp on my securities analysis and public market idea generation skills. As such, I've picked this project as the forum to accomplish this and I've selected the Micro-cap & Over-the-Counter ("OTC") stock markets as the subject matter. My goal in this exercise is to provide some informative (and hopefully fun and interesting) insight into a market that I've grown very interested in personally to a small set of friends in a private setting. Accordingly, I would ask that if you have friends that you believe would enjoy this letter, that you introduce them to me over email rather than forwarding the file. Similarly, I have respect for everyone that is receiving this letter's judgement, intelligence and professional experience and I would appreciate hearing any feedback you may have along the way on any topic that I cover.

Before diving in, I thought I'd share some background on my interest in micro cap and OTC stocks. In 2011 I had a lull in activity at work and started looking at stock screens of US-based companies trading under 5x EBITDA. This list was longer back then than it would've been in 2018 or 2019 and now the list of deeply-depressed trading multiples has come back around to higher levels. At that time, based on screening results and superficial analysis, I got interested in Calloway's Nursery (OTC: CLWY). The company was trading at ~4x EBITDA, but owned land underlying its retail locations that even the most cursory analysis of comps would indicate was worth many multiples of the stock's market valuation. However, CLWY was a neglected and overlooked stock, there was no apparent catalyst, and extremely thin trading volumes. The key question for me at the time was whether management was running the business in a manner that optimized value for shareholders (answer was "maybe" or "mostly" but it could be improved) and whether management was syphoning off value that should go to shareholders via enormous salaries, private jets, extreme option packages or the like (answer was "no"). Around this time I had the privilege of a meeting with Seth Klarman of Baupost Group (shortly after I had read a bootlegged version of his book *Margin of Safety*[1]). Reading *Margin of Safety* played some role in my interest in extending the stock screening I was doing to all market capitalizations whereas previously I might have looked at $200 million and up traded on a major exchange. I was early in my career as an allocator at the time and I asked Mr. Klarman… "What criteria do you require to purchase a value stock?", "Does management have to be excellent?", "Must there be a catalyst in place?". Mr. Klarman answered that in extreme deep value situations all the boxes rarely are checked, you want to have a stable industry but you aren't going to find a deep value stock as the leading player in a rapidly growing industry, and, no, a catalyst is good, but not required. Shortly after that I had the privilege

[1] For the record, the bootlegged part I admitted to Mr. Klarman and he absolved me of any ethical or legal breach. *Margin of Safety* original copies sell on Amazon for several thousands dollars a piece as its out of print and in high demand. I highly recommend the book in spite of its scarcity and admire Mr. Klarman and Baupost Group tremendously.

of a meeting with Jim Chanos of Kynikos Associates. At that meeting he more unequivocally told me that "catalysts are something that people point to and create a story around after the fact and its rarely clear going into a situation". Other investors might express a similar sentiment that if you buy right and look after your downside, "the upside takes care of itself". So I concluded that CLWY was extremely undervalued, purchased several hundred thousand dollars of stock for a ~3% position at around $0.80-0.90 cents per share. I started attending CLWY's annual shareholders meetings, getting to know other shareholders, and asking management questions about their results. Before long the upside did take care of itself as 3K Limited Partnership, a family office of Peter Kamin one of the founders of ValueAct Partners (a leading activist hedge funds) built a major position, decided that they would be the catalyst, and ran a proxy contest that resulted in a shift in strategy for the company (realizing value of the real estate holdings) and their representatives sitting on the board of directors. I sold way too early (around $2.20 / share in late 2014), which is a frequent problem of value investors. The stock today sits at $4.40 in the COVID sell-off after peaking over $8 / share earlier.

Subsequent to CLWY, I made significant (for my personal account) investments in Precision Tune Auto (OTC: PACI) which was later acquired by Icahn Associates at a significant premium, Tropicana Entertainment (OTC: TPCA) where I was investing in the same post-reorg equity that Icahn Associates had purchased, and got involved in several other similar situations. The common factors that got my attention in a given investment opportunity were underfollowed and overlooked securities, severe undervaluation (typically, under 5x EBITDA, under 0.5x book value, or single digits P/E multiple). From there I focused on a negative screen (i.e., look for reason to throw out a name) based on weak or dishonest management, unusual accounting or lack of a legitimate auditor (note: this doesn't mean it has to be a big four firm), litigation exposure, or lack of stability in the business or industry in question. In applying these criteria, however, I always kept the advice from Mr. Klarman (every single factor rarely lines up in deep value situations) and Mr. Chanos (catalysts often are just stories re-created after the situation plays out). From Mr. Kamin, I learned how an investor can be their own catalyst even in a tiny OTC stock with high management ownership.

Macro Thoughts

I will generally start these letters with some macro thoughts and observations. I'm not an economist[2] and I'm preparing these letters on nights and weekends, so certainly am not seeking to compete with the excellent macro letters that already are out there (my favorites are *BCA Research* and Bridgewater's *Daily Observations)*, but I will do my best to synthesize what I'm seeing and hearing and my reactions to these data points and perspectives. From a macro standpoint today any conversation starts and stops with the COVID-19 pandemic and the massive policy response by Central Banks and Treasury Departments across the World.

Before going into some of my thoughts, a recommendation. I suggest that everyone listen to Ray Dalio's recent *Ted Talk* podcast interview[3]. Mr. Dalio's assertion in this interview that we are headed for another "Great Depression" grabbed all the headlines and people should take notice of a statement like this from perhaps the leading macro investor in the World, however, I found the interview to be much more nuanced than the superficial articles that immediately popped up afterwards on a range of websites and news services. Dalio is quite concerned about the implications for economic growth, for corporate and sovereign balance sheets and reminds investors to pay heed to diversification and "have a little gold" in their portfolios. But I thought he also put severe contractions (which likely is happening here and

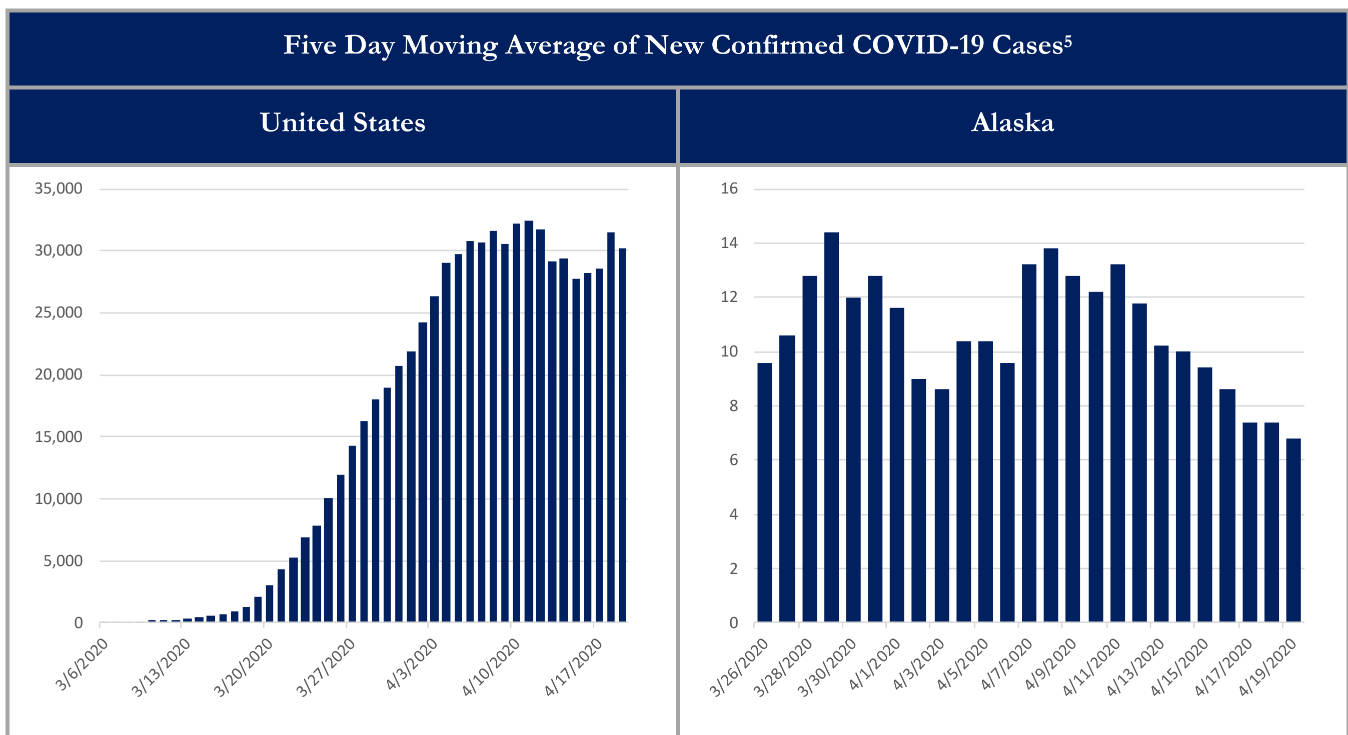
[2] Although every time I say "I'm not an economist" I'm reminded of a persuasive presentation conveyed via a 100 page powerpoint deck from a highly-qualified economist presented to the investment firm I worked at in 2007 that argued emphatically that the cracks starting to form in the sub-prime mortgage market was **not** something to be overly concerned about.

[3] Ted Talks Daily from Thursday, April 9, 2020 "What Coronavirus Means for the Global Economy – Ray Dalio".

has happened periodically in the past) in historical context and reminded listeners in a more uplifting fashion that "The greatest force through time is human inventiveness. The greatest force of that is re-inventiveness." In short, Mr. Dalio is confident that we will get through this and the important thing is to focus on education (policy makers should be as focused on making sure cash strapped local governments don't stop funding education as on preventing short term job losses) and innovation. Stopping short of a complete summary of the interview, I will simply note that it was not all dire predictions of impending Depression and had significant coverage of Dalio's views of how we can and should respond to end up in the best possible place.

With Ray Dalio's views framed in a more balanced manner than headlines about economic depressions, I will share my views. It seems to me that uncertainty is just about as high as it possibly can be. On one hand, we now have an implied unemployment rate in the United States that went from multi-decade lows to post-WW II highs in a matter of weeks. Many respected epidemiologists are cautioning that life will not return to normal until a vaccine for COVID is discovered and mass produced, which could take more than a year[4]. On the other hand, the market has been encouraged by declining infection rates and potentially resumption of normal life in the near future in places like Italy, Spain and New York.

I have been tracking the COVID data released on Johns Hopkins website and the charts below show what I'm seeing. As of mid-March the rolling five day moving average of new US cases was around 500, this ramped up rapidly to 25,000 new cases per day by the end of March, peaked around 32,000 from April 10-12, and subsequently has dropped off to 30,262 as of April 19. In Alaska (where I'm writing from), cases have grown, which is alarming to people who live here, but it has not hit exponential growth. At recent levels of growth just under 2% of the US population and under 0.5% of the Alaskan population will contract the virus by the end May (and these numbers are down from 50+% infection rate by end of May using daily case growth rates from just a month ago). It appears that the trajectory of the infection rate in the US has come down very materially.

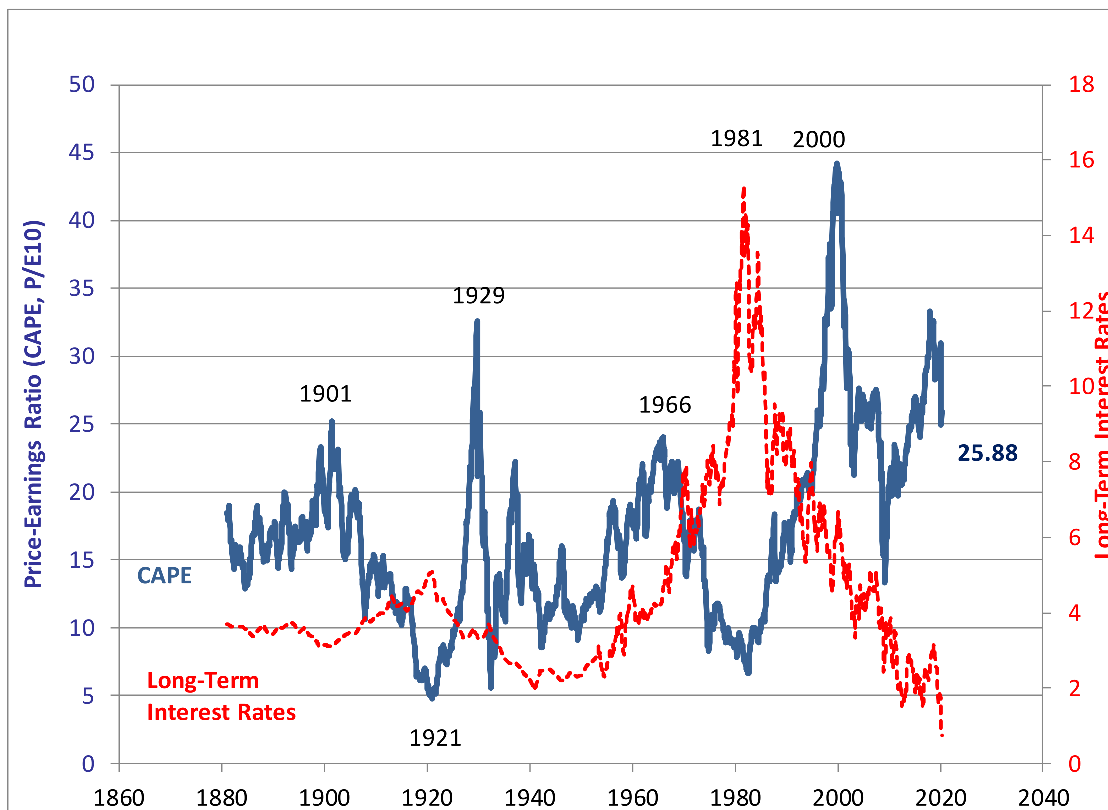


[4] https://nypost.com/2020/04/14/harvard-researchers-say-coronavirus-social-distancing-may-be-until-2022/

[5] Source: Author's daily tracking of data from Johns Hopkins and Alaska DHSS.

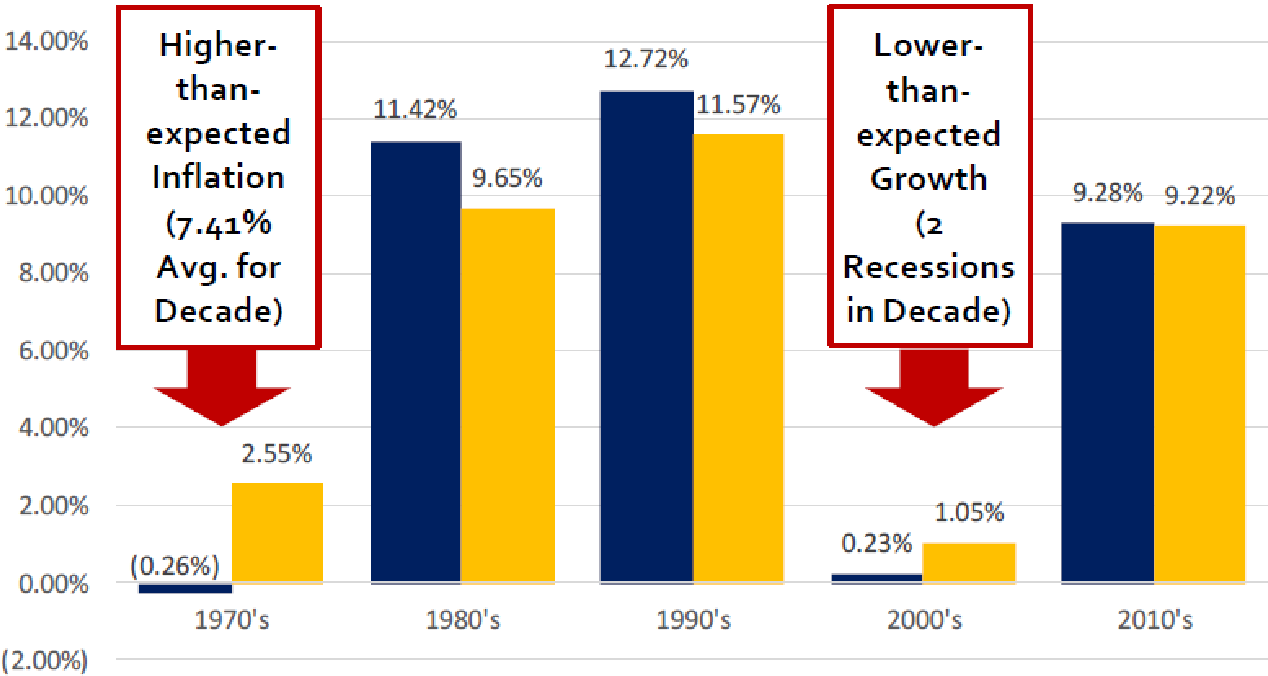
I am struck, however, by the fact that even though 20-30% daily case growth has been replaced by low-to-mid single digit growth, this has only been accomplished by measures that are taking extreme impact on the economy. And, in spite of this, the virus can hardly be called contained and daily death counts in places like New York and Italy even if moderating can only be described as horrifying. There are still ~30,000 new cases / day in the United States (near peak levels) and Juneau, Alaska cases were continuously ticking up slowly until the last four days where there wasn't a single new case (ominously of the 24 cases that we have in Juneau, 7 are corrections officers at the local prison with the zero cases among the 200+ inmates raising the question of what the level of testing really is). There are questions about what case counts would look like with adequate testing and absent a vaccine, uncertainty abounds particularly if we move in the near term toward a re-opening of the economy.

To me this uncertainty is in the extreme – in the United States a Treasury Department that was already running record budget deficits and a Federal Reserve that was already operating with microscopic interest rates and growing its balance sheet in response to pre-Virus disruption in the Repo market is what stands between us and, as Ray Dalio predicts, a Depression. At my day job managing a ~$60 billion state fund, we entered February with ~$5 billion overweight to investment grade fixed income and cash (the view was generally bearish with the observation that equities represented a poor risk /reward profile). Today we've shifted to running as tight to our benchmark weights as possible (we were active buying equities in early March and now the likely next path is trimming equities with the $150 mm of equities we sold this week being our first sales since mid-February). I'd argue that investors running money against a benchmark with a diverse mix of assets should manage close to these benchmarks. Stocks remain expensive by historical standards (based on Shiller cyclically-adjusted P/E multiple) and the potential downside seems very large. However, conversely, running an underweight to stocks here exposes an investor to extreme underperformance if a breakthrough medical treatment come available earlier than expected and before the worst of the damage to balance sheets, labor markets and credit markets globally. Tight to the benchmark is the way to go here for institutional investors.



Source: http://www.econ.yale.edu/~shiller/data.htm

Before transitioning to micro/OTC-market specific observations and ideas, I will conclude with some thoughts on inflation and gold. Again, I emphasize that I am not an economist (with the same footnote I had the first time I said this here) and my method here is synthesizing views and data I've digested elsewhere. At the last board presentation for my day job in February, I requested permission from our Board to include Gold (via ETF's) in the investable mix of our fund. This request was influenced by the overall extremely high valuation environment for equities (see CAPE Ratio on prior page) as well as a recognition that traditional institutional portfolios tend to be exposed to underperforming vis-à-vis their objectives in periods of lower than normal economic growth and higher than normal inflation (assuming that a fund's return objective is expressed as a premium to CPI). Gold appeared to me to be the best asset to access to improve portfolio performance in these types of macro regimes. As the following chart shows the addition of a 10% allocation to Gold (taken from Fixed Income) improves the return of a traditional 60/40 portfolio while materially improving the real return it would have generated in the difficult decades for real return investors of the 1970's and 2000's.



I continue to like Gold here and in spite of market consensus for future inflation running below the Federal Reserve's stated target of 2%, I am noticing some signs of investors starting to think about inflation as a significant risk factor going forward. One such example is JP Morgan in their Q2 2020 "Global Asset Allocation Views" report (released this month) which states: "As growth slumps in 2020, we expect bond yields to fall further and for negative stock-bond correlation to reassert itself. But further out, fiscal stimulus together with low policy rates may ultimately have a bigger inflationary impulse than monetary policy alone." The analysts at JP Morgan go on to point out "A key lesson we learned from the last business cycle was that extraordinary measures taken in times of panic become ordinary policy measures later in the cycle". This was clearly the case with the various rounds of QE and rate cuts executed in mid-cycle slowdowns between 2008 and 2019".

So Modern Monetary Theory (MMT) appears to have arrived in the form of "unlimited" QE, deficit stimulus spending on top of existing deficit spending, and JP Morgan advises us to prepare for the possibility that it will be around for a while. While the market observers in the deflation camp are focused on the flow through of virus weakened demand and plummeting oil prices, I believe (re-enforced by my quarantine-related recent binge watching of the Milton Friedman *Free to Choose* series on Amazon Prime, which I highly recommend) that investors may want to heed Professor Friedman's observation on the topic that "Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output". It would seem that Professor Friedman, if alive today, might be cautioning that the virus-induced reduction in economic output coupled with frantic money printing by the World's Central Banks could be dangerously inflationary.

Later in this letter you will see that I am suggesting a portfolio approach to micro and OTC stocks of 50% Gold and 50% stocks. It is with this concern for inflation in mind (and gold's unique ability to mitigate inflation) and with the goal of a balanced risk portfolio that I suggest this positioning.

Benchmarking Micro Cap & OTC Securities

Benchmarking equity markets is always difficult, but in the micro cap and OTC world the lack of a good broad market gauge increases this challenge. The S&P 500 is increasingly dominated by the large cap technology stocks, the most prevalent small cap benchmark (Russell 2000) includes stocks with market capitalizations as high as $10 billion, and the Russell Micro-cap Index (less well known than Russell 2000 but closer to target on size of constituents to what we are covering here) is dominated by unprofitable companies (majority of companies have negative Net Income) and biotech stocks.

Because a sensible investment strategy should focus on companies that do make money and a balanced sector mix (neither of which are traits of the Russell Micro-Cap Index), I have constructed a custom index for purposes of tracking the market. This custom index ("Custom OTC/Micro Index") includes companies in approximate sector mixes of the Russell 2000 and while deep work was not done on each stock, generally includes "real businesses" that earn profits, are professionally managed, and provide valuable products and services for customers. There are no shell companies or promotional schemes in the mix. The twenty constituents of this custom index are shown on the following page – these businesses contrast with the top twenty positions in the Russell Micro-Cap Index, 16 of which are healthcare companies (14 classified as biotech) and 17 of which have negative LTM Net Income. So while the Custom OTC/Micro Index may appear to be an arbitrarily assembled group of twenty stocks (and a narrow index at 20 names), it should provide a better basis for discussing how securities are moving in the market segment that this letter is devoted to than the existing Russell options.

The following chart highlights the performance of the Custom Micro/OTC Index versus major US equity indices going back to 2018. Please note the strong outperformance of the S&P 500 vs. the two Russell indices, which is driven by extreme outperformance of the large cap tech bellweathers. If an investor has been overweight large cap technology, congratulations on the prosperous run, if one has a contrarian bone in their body, however, I'd suggest looking around smaller-cap value stocks (whether of the OTC variety or those within the Russell 2000).

Total Return Including Dividends	**2018**	**2019**	**YTD 3/31/20**	**MTD 4/9/20**	**Cumulative**
Russell Micro-cap Index	(13.08%)	22.43%	(31.99%)	6.24%	(23.11%)
Russell 2000	(11.01%)	25.52%	(30.61%)	8.16%	(16.18%)
S&P 500	(4.38%)	31.49%	(19.60%)	8.02%	9.18%
Large Cap Tech [1]	8.07%	47.78%	(4.70%)	1.85%	55.01%
Custom OTC/Micro	(12.64%)	23.43%	(15.75%)	3.94%	(5.58%)
Custom vs. Russell Micro-cap	*0.44%*	*0.99%*	*16.23%*	*(2.29%)*	*17.53%*

1. Facebook, Apple, Netflix, Alphabet, Microsoft.

($ in millions)

	Mkt. Cap	LTM P/E	Div. Yield	Industry
Alaska Communications Systems Group, Inc.	$103	21.60x	0.0%	IT & Communication Services
Alaska Power & Telephone Company	$61	9.70x	3.8%	Real Estate & Utilities
BEO Bancorp	$35	8.30x	3.0%	Financials
Bioqual, Inc.	$63	16.30x	1.0%	Healthcare
Conrad Industries	$71	NM	0.0%	Industrials
CynergisTek, Inc.	$16	NM	0.0%	Healthcare
Educational Development Corporation	$39	6.80x	4.4%	Consumer
Flanigan's Enterprises, Inc.	$23	6.70x	0.0%	Consumer
Gencor Industries	$157	12.80x	0.0%	Industrials
HG Holdings, Inc.	$8	44.12x	0.0%	Real Estate & Utilities
Kansas City Life Insurance Company	$274	11.20x	3.8%	Financials
Liberated Syndication Inc.	$85	19.70x	0.0%	IT & Communication Services
Mechanical Technology, Inc.	$5	17.70x	0.0%	IT & Communication Services
Monarch Cement	$191	5.80x	3.7%	Industrials
National Security Group, Inc.	$38	9.30x	1.6%	Financials
Ojai Oil Company	$23	21.86x	2.1%	Real Estate & Utilities
Pardee Resources Company	$79	10.57x	6.1%	Energy
Scientific Industries, Inc.	$17	49.50x	0.0%	Healthcare
The Goldfields Corporation	$77	11.50x	0.0%	Industrials
Triple-S Management Corporation	$369	3.90x	0.0%	Healthcare
Average	$86.6	15.96x	1.5%	
Median	$62.4	11.35x	0.0%	

Note: as of April 9, 2020.

While the purpose of this custom index is to follow the market going forward using stocks more representative of a sound approach in the micro-cap and OTC market (varied industries, profitable companies), the historical data has some interesting characteristics. In recent market drawdowns (2018 and YTD 3/31/20) these small companies are relatively resilient and from 12/31/17 to the present they have outperformed the Russell Micro-cap Index and Russell 2000. The S&P 500 with its heavy concentration in large cap tech stocks remains tough to beat with a cumulative return of 9.18% since 12/31/17 vs. losses for all of the other indices over this period through April 9, 2020.

Portfolio Construction & Tracking the Performance of Ideas Discussed Here

As I proceed with this letter, I plan on introducing one or two new long stock ideas in each monthly edition. While the ideas are not investment recommendations technically, they are introduced for discussion purposes as a good long position idea. When there are material updates on past ideas, I will provide them in the next monthly edition and if they no longer appear to be a good long position idea, I will update readers with that view. Most investment letters I read, I find the lack of tracking and follow-up on ideas discussed to be of particular annoyance. I will address that here by registering and tracking how past ideas do in a format that will follow.

A major portfolio construction belief of mine with micro caps and OTC stocks, is that in a portfolio they should be paired dollar-for-dollar with a liquid, low risk, uncorrelated diversifying asset. Short positions in these types of small

and illiquid securities is typically not possible and even when shares are available to borrow this activity is ill advised. As a result, typical hedge fund strategies of matching long positions with short positions isn't practical and on a stand-alone basis these are quite risky, illiquid investments. I prefer pairing long positions in micro cap and OTC stocks with a Gold ETF[6] - this positioning reflects, in a bar-bell fashion, how speculative these small stocks are, provides a large portfolio position in an asset that is defensive and inflation protected, and enables a portfolio manager to engage in frequent rebalancing (i.e., trim stocks on strength and buy gold, add to stocks on weakness funded from selling gold). It has been said that "diversification is the only free lunch" in investing; I would argue that this type of portfolio rebalancing is the other free lunch as it adds return and reduces volatility.

The math behind this observation is included in the following table. Gold (IAU) has delivered an annualized return of 4.3% since 2006 with the Russell Micro-Cap Index (as flawed as it is) behind that at 2.4% annualized. A 50/50 portfolio of the two, rebalanced annually would have delivered a 4.8% annualized return, larger than either of the two alone. Quarterly rebalancing increases the annualized return further to 4.9%. Portfolio volatility is reduced from 16.2% for Gold and 22.0% for the Russell Micro-Cap Index to 13.5% for the portfolio rebalanced annually and 12.0% with quarterly rebalancing. Ideally an investor with skill in selecting micro and OTC stocks can add significant value beyond these equity indices and the power of pairing a low risk liquid asset with these positions from a balanced risk and portfolio rebalancing standpoint would hold all the same.

	Gold (IAU)	Russell Micro-Cap	*50/50 MC/GLD*	Russell 2000	*50/50 R2000/GLD*	S&P 500
2006	22.27%	16.54%	*19.41%*	18.37%	*20.32%*	15.79%
2007	30.36%	(8.00%)	*11.18%*	(1.57%)	*14.39%*	5.49%
2008	5.11%	(39.78%)	*(17.34%)*	(33.79%)	*(14.34%)*	(37.00%)
2009	23.90%	27.48%	*25.69%*	27.17%	*25.53%*	26.46%
2010	29.46%	28.89%	*29.17%*	26.85%	*28.16%*	15.06%
2011	9.57%	(9.27%)	*0.15%*	(4.18%)	*2.70%*	2.11%
2012	6.89%	19.75%	*13.32%*	16.35%	*11.62%*	16.00%
2013	(28.25%)	45.62%	*8.68%*	38.82%	*5.29%*	32.39%
2014	(2.05%)	3.65%	*0.80%*	4.89%	*1.42%*	13.69%
2015	(10.58%)	(5.16%)	*(7.87%)*	(4.41%)	*(7.50%)*	1.38%
2016	8.31%	20.37%	*14.34%*	21.31%	*14.81%*	11.96%
2017	12.91%	13.17%	*13.04%*	14.65%	*13.78%*	21.83%
2018	(1.76%)	(13.08%)	*(7.42%)*	(11.01%)	*(6.39%)*	(4.38%)
2019	17.98%	22.43%	*20.21%*	25.52%	*21.75%*	31.49%
Annual Re-balancing / Data						
Total Return	180.3%	139.2%	***193.5%***	200.0%	***219.8%***	247.1%
Annualized Return	4.3%	2.4%	***4.8%***	5.1%	***5.8%***	6.7%
Worst Drawdown	(40.88%)	(47.78%)	***(17.34%)***	(35.35%)	***(14.34%)***	(37.00%)
Annualized Vol	16.2%	22.0%	***13.5%***	19.3%	***13.0%***	17.6%
Return/Risk	0.27x	0.11x	***0.36x***	0.26x	***0.45x***	0.38x
Quarterly Re-balancing / Data						
Total Return	180.3%	139.2%	***196.3%***	200.0%	***225.5%***	247.1%
Annualized Return	4.3%	2.4%	***4.9%***	5.1%	***6.0%***	6.7%
Worst Drawdown	(47.28%)	(72.24%)	***(25.07%)***	(59.17%)	***(21.40%)***	(56.83%)
Annualized Vol	14.5%	21.3%	***12.0%***	19.2%	***11.4%***	15.2%
Return/Risk	0.30x	0.11x	***0.41x***	0.26x	***0.53x***	0.44x

Therefore, in future editions of this letter you will see long positions that have been identified tracked alongside an equal investment in Gold with periodic rebalances back to 50/50. Now onto to some stock ideas.

[6] On the basis of fees alone IAU is preferable to GLD in spite of GLD being the more widely known Gold ETF.

Ojai Oil Company (OTC: OJOC)

Famously during the dot-com bubble of the late 1990's and early 2000's firms with ".com" at the end of their name would achieve valuations far in excess of their peers with more staid corporate handles. And again in the past several years we've seen this phenomena repeat itself with firms in mature industries re-naming themselves to something associated with blockchain. Even more recently, one needs to look no further than the 1890% appreciation that ZOOM Technologies, Inc. (OTC: ZOOM) shareholders enjoyed from 12/31/19 to 3/20/20 to see the importance of a name to a stock. In this case, uninformed speculators mistakenly associated this zero revenue, China-based communications technology firm with the more widely used Zoom Video Communications, Inc. (Nasdaq: ZM) who is, of course, enjoying a surge in usage from the many people who find its services to be the only way to conduct social activities ranging from Board meetings to Tinder first dates given the realities of COVID. Perhaps the most amazing part of the Zoom story is that this April 2020 event is not the first time that uninformed speculators ran up ZOOM mistaking it for ZM as a very similar episode happened in April 2019 [7]. Clearly in the stock World, and especially at times in the OTC stock World, a company's name can matter.

The business under examination in this first edition of *The Micro Cap & OTC Stock Letter* has turned these superficial naming strategies on their head. Ojai Oil Company (OTC: OJOC) is an anomaly in that the company derives the vast majority of its revenues and operating profits from the real estate business, but by retaining its original name it gives a nod to its history as a business focused on oil & gas extraction (mostly in California). Ojai Oil carries this name proudly even if oil & gas in 2020 is far from "dot coms" in 2000, blockchain in 2018 or video communications in the time of COVID. Importantly, while casual observers might overlook a terrific value opportunity given that we are in a $25/barrel oil price environment (scratch that, as of 4/20/20 in a negative oil price environment) with energy as a consistent, repeat leader in worst sector performance rankings, a more careful look at Ojai Oil Company reveals a deep value play on the self storage market. So in today's hyper-ESG focused world while companies like Goldman Sachs announce that they will not take companies public without appropriately diverse Boards (while more quietly disclosing that this policy doesn't apply to Asia and some other Emerging Markets where perhaps companies need more encouragement for diversity, but where such a policy would adversely impact investment banking business) [8] or JPMorgan proclaims it will not finance Arctic energy extraction[9] (but remains quiet on the bigger and more lucrative market of working with producers, including frackers, in other parts of the World), Ojai Oil Company appears to be focused on growing value for shareholders without undue attention on naming and optics.

I would conclude confidently that while name and superficial optics may matter in the short term, fundamentals (compounding growth in book value, smart capital allocation, GAAP earnings, relative valuation vs. comparable companies and cash dividends) matter in the long term.

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[7] https://markets.businessinsider.com/news/stocks/publicly-listed-zoom-video-communications-traders-buying-zoom-technologies-2019-4-1028122561.

[8] https://www.nationalreview.com/news/goldman-sachs-exempts-all-asian-companies-from-new-ipo-diversity-pledge/

[9] At negative WTI prices, I wouldn't be excited about financing Artic oil exploration either, but I suspect there may be some upside to WTI from here.

Ojai Oil Company – At a Glance

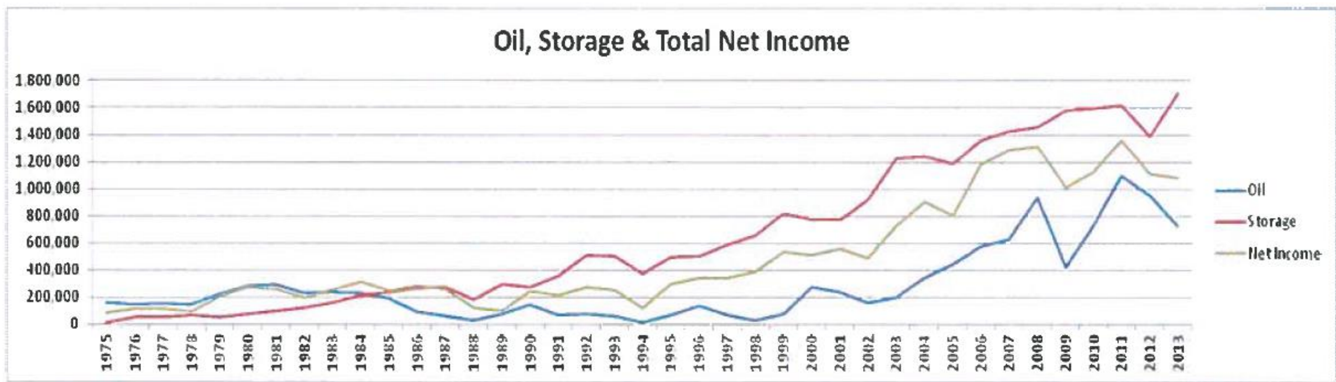
Ojai Oil Company is based in Southern California and was incorporated in 1900 with 25 original shareholders each contributing $14,000. The company's first 50 years were involved in oil field investments, but fluctuating commodity prices over the years led management to diversify into a range of other activities, most notably self storage real estate investments. Management and insiders own a majority of shares outstanding rendering activism largely futile and the negative screen therefore more critical. In fact, I learned about this opportunity from an investor who has for many years run a relatively large fund focused on micro caps who specifically avoids hostile situations in favor of investing in well run companies, with high management skin in the game, purchased on the basis of value and the proverbial "waiting for the upside to take care of itself". Based on the trading dynamics of the stock (discussed later), it had to have taken many years for this investor to build a large enough position in the stock to make sense for his fund.

The data below shows how Ojai's management has successfully pivoted away from oil & gas in favor of real estate investments and profile of the business today. Management has been using free cash flow and mortgage borrowings over the time-frame highlighted below to grow its self storage portfolio in California and Nevada. Included in this strategy are the purchases of under-managed facilities as well as ground-up development. It would be reasonable to assume that EBITDA could ramp up organically from here on certain of these properties, however, we'll use reported LTM EBITDA of $4.9 million for all purposes here in the interest of conservatism.

($ in thousands)

Fiscal Year Ending December 31,	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenues									
Oil Operations	$1,400	$1,370	$1,329	$980	$569	$418	$537	$900	$763
Self Storage	2,969	3,027	3,530	3,818	5,784	6,795	7,776	9,015	12,342
Other	1,591	1,344	1,496	1,544	207	188	171	20	(2,379)
Total Revenues	**$5,960**	**$5,741**	**$6,355**	**$6,342**	**$6,560**	**$7,401**	**$8,484**	**$9,935**	**$10,726**
Growth	--	***(3.7%)***	***10.7%***	***(0.2%)***	***3.4%***	***12.8%***	***14.6%***	***17.1%***	***8.0%***
EBIT									
Oil Operations	$1,087	$967	$756	$649	$166	$170	$234	$355	$369
Self Storage	1,621	2,646	1,659	2,783	3,531	4,150	4,610	5,639	5,810
Other (Including SG&A)	(134)	(1,704)	(664)	(1,419)	(1,748)	(1,751)	(2,367)	(3,092)	(3,619)
Total EBIT	$2,574	$1,909	$1,751	$2,013	$1,949	$2,569	$2,477	$2,902	$2,560
Margin	*43.2%*	*33.3%*	*27.6%*	*31.7%*	*29.7%*	*34.7%*	*29.2%*	*29.2%*	*23.9%*
EBITDA	**$3,079**	**$2,405**	**$2,399**	**$2,654**	**$2,899**	**$3,469**	**$3,805**	**$4,861**	**$4,932**
Margin	***51.7%***	***41.9%***	***37.8%***	***41.9%***	***44.2%***	***46.9%***	***44.8%***	***48.9%***	***46.0%***
Net Income	$1,358	$1,112	$1,081	$1,574	$1,178	$1,440	$1,236	$3,580	$1,053
Dividends Per Share	$0.85	$0.90	$0.93	$1.00	$1.07	$1.20	$1.25	$1.35	$1.65
Dividends Paid - $	$248	$262	$271	$291	$312	$349	$363	$392	$473
Payout Ratio	*18.2%*	*23.6%*	*25.1%*	*18.5%*	*26.5%*	*24.2%*	*29.4%*	*11.0%*	*44.9%*
Shares Outstanding	291,313	291,313	291,313	291,213	291,213	290,715	290,702	290,702	286,804
Balance Sheet									
Total Debt	$6,080	$5,667	$4,556	$4,232	$3,887	$5,093	$14,613	$21,165	$28,539
Book Value of Equity	12,389	13,266	14,128	15,404	16,182	16,931	17,947	21,182	21,435
Total Capitalization	$18,469	$18,933	$18,684	$19,636	$20,069	$22,024	$32,560	$42,347	$49,974
Cash & Marketable Securities	$3,412	$2,884	$2,855	$2,914	$3,890	$2,207	$6,264	$2,656	$12,251
Net Debt / LTM EBITDA	0.87x	1.16x	0.71x	0.50x	0.00x	0.83x	2.19x	3.81x	3.30x

Further highlighting the transition from Oil to Self Storage from a long-term perspective (as well as total Company profitability over cycles) is the following chart from the Company's 2013 annual report.



Valuation

The appeal of OJOC, in short, is a compelling valuation and conservative balance sheet coupled with lack of negative screening items (in other words, red flags). It has been run as an OTC stock for many decades, management appears honest and conservative (with significant skin in the game), an annual dividend is paid, and share count is stable without any material dilution (from option grants or RSU's). The primary negative is the lack of a catalyst; an investor must be patient, collect their dividends, and "let the upside take care of itself".

The table below highlights OJOC's trading levels versus other leading publicly-traded self storage owner-operators. OJOC's materially lower valuation multiples and lower leverage profile highlights the attractiveness of the value opportunity (with OJOC diminutive size and lack of liquidity the clear offsetting negative).

($ in millions)

Company	Market Capitalization	Enterprise Value	TEV / LTM EBITDA	LTM Price / Earnings	Leverage (Debt + Pref - Cash) / EBITDA	Price / Book Value
Ojai Oil Company (OTC: OJOC) at last trade	$22.9	$39.2	7.95x	21.79x	3.30x	1.07x
Ojai Oil Company (OTC: OJOC) at high bid	$19.5	$35.8	7.26x	18.52x	3.30x	0.91x
Ojai Oil Company (OTC: OJOC) at low ask	$28.2	$44.5	9.02x	26.76x	3.30x	1.31x
Self Storage Comps						
Public Storage (NYSE: PSA)	$34,358.2	$39,887.2	19.50x	27.00x	2.71x	3.78x
Extra Space Storage Inc. (NYSE: EXR)	$12,123.2	$17,723.2	19.90x	28.80x	6.12x	4.15x
Life Storage, Inc. (NYSE: LSI)	$4,366.7	$6,330.6	18.60x	16.80x	5.81x	2.02x
National Storage Affiliates Trust (NYSE: NSA)	$2,606.9	$4,112.3	18.10x	NM	7.87x	1.80x
Comps Average	$13,363.8	$17,013.3	19.03x	24.20x	5.63x	2.94x
Comps Median	$8,245.0	$12,026.9	19.05x	27.00x	5.97x	2.90x

Stock Trading Dynamics

A discussion of Ojai Oil Company would be incomplete without a review of trading dynamics. The current bid/ask spread on the stock is $68.00 bid and $95.25 asked. Therefore, 100 shares could be purchased at $95.25 for an initial investment of $9,525. If one were to take this opportunity it would represent the first time since February that shares traded (in February 2020, 200 shares traded at a price of $85.25 and 100 traded at a price of $80). To look earlier than February one would have to go back to November 2019. An extraordinarily illiquid stock like this with a wide bid/ask spread is both an opportunity and an issue. The opportunity derives from the ability for a trader to sit as the high bid for a long time until they can pick off a seller at a very opportune price. The obvious issues are that it takes a long time to build a position and once in it is hard to get out. The set-up is terrible for a short term trader and excellent for a very long-term, patient investor who doesn't expect to need liquidity for several years. Stocks like OJOC also "trade by appointment" (in many some cases more frequently than electronically through brokerage platforms). A shareholder

friendly management like that at OJOC would likely introduce selling shareholders to those who have expressed an interest in buying (this can be a great way to build a position too) or buy the shares themselves. There are better ways to exit a position than dumping them on the market and many ways a patient investor can build a position over several years.

Additional Information on Ojai Oil Company

While it is quite rare to see traditional Wall Street equity research on micro cap stocks anymore, there are a few sites that provide good coverage on individual names – www.otcadventures.com is one that I have generated good ideas from in the past. Also, www.seekingalpha.com has good content from thousands of individual contributors. Unfortunately, much of the best content on the site is behind a paywall. For those of you who are subscribers to Seeking Alpha, there is one article and an accompanying podcast episode about Ojai Oil Company available here (https://seekingalpha.com/article/4235632-ojai-oil-company-podcast).

Beyond the coverage described above, which can provide good summary introductory information on a business, the best place to go is the company's Investor Relation website (http://www.ojaioil.com/investors), which in Ojai's case has annual reports going back to 2010. The outbreak of COVID has caused management to conduct their annual meeting this year virtually instead of in person (event occurred on April 14th) and information on this was available ahead of time to interested shareholders via the investor relations site. At the time that this letter went to print there was no confirmation available, however, on whether Ojai used Zoom Video Communications, Inc. or accidently booked ZOOM Technologies, Inc. to host the meeting!

Barnes & Noble Education, Inc. (NYSE: BNED)

In future editions I will spend more time on the process of idea generation. However, for now, with time being everyone's most precious commodity, a valid and important method for idea generation is following trades done by investors you respect. One such investor for me is Rory Wallace at Outerbridge Capital. I've been an investor in Rory's fund for approximately three years now and found him to be thoughtful and well researched in everything he pursues[10]. I've also been impressed by Outerbridge's willingness to embrace volatility and express views with large position sizes in a hedge fund market where managers increasingly cater to allocators low vol preferences. Through Outerbridge's thorough investor updates I've come to appreciate that the firm focuses on technology stocks, but without the emphasis on FANG names that is seemingly ubiquitous these days. The firm comes at the technology space with a focus on situations that represent compelling value. The Outerbridge portfolio is not one where you will find too many cloud computing companies trading at 10x Revenues.

Accordingly, I took attention when Outerbridge made Barnes & Noble Education, traditionally a brick-and-mortar bookseller on college campuses, a top position (which was publicly announced in a 13D filing last September). In the time of COVID, with students participating in classes remotely, it would seem that BNED is in a tough spot for the near term in addition to the longer-term headwinds and uncertainty inherent in operating physical bookstores in the 21st century. The market has reacted, as such, knocking BNED shares down from $4.27 at the end of 2019 to $1.91 as of April 20th. The resultant multiples (1.5x TEV / EBITDA, 0.3x price / tangible book) are mouth watering for a viable ongoing concern but potentially a value-trap if buying BNED is tantamount to investing in the "last buggy whip manufacturer". To have a smart technology investor like Mr. Wallace in the stock, however, provides a shred of hope for adventurous and risk-tolerant value investors to go off of. My closer look also revealed that while BNED is technically a retailer it enjoys a captive market at its campuses, much lower fixed costs (most rent arrangements are simple % of sales arrangements without fixed minimums), and a potentially countercyclical profile (college enrollment

[10] For more information on Outerbridge Capital please visit www.outerbridgecapital.com.

has been shrinking in recent years but was up double-digits in the GFC). The trends in the business are not bad (*CapitalIQ* has LTM Revenues and EBITDA at $1.9 bn and $80 mm, respectively, roughly flat from the $1.8 bn and $80 mm in 2016 -- the company's first year as an independent entity post-spin off from the better known Barnes & Noble)[11]. BNED is trading at 0.2x revenues vs. its primary competitor in its digital business Chegg (NYSE: CHGG) which trades at 11x revenues (and 87x LTM EBITDA). To get a fair valuation it sounds like its time for a name change or a "dot com" at the end of BNED!

Craig Hallum research (only one of three analysts covering BNED) is also optimistic highlighting growth in the company's digital segment as well as the strategic value of the company's locations on college campuses (recent strategic partnerships with AT&T and Urban Outfitters to share space in BNED's physical locations highlight a new push by management to maximize the value of access to the coveted demographic group of college students). Pre-COVID Craig Hallum covered BNED with a Buy rating and $5 price target, however, on March 16, the firm downgraded BNED to Hold with a $2.50 price target based on the impact of "social distancing" on future company results. In the only open market transactions by management in the past year, CEO, Michael Huseby, provides a somewhat luke warm affirmative vote with his June 2019 open market acquisition of $90,000 of stock at a price of $3.60 (as compared to his 2019 total compensation in excess of $2 million).

In January 2020, recognizing that the market was not affording the stock a reasonable valuation, Barnes & Noble Education retained Morgan Stanley to evaluate strategic alternatives and no outcome of this process has been announced thus far. With this quick short-form idea note, I'll add BNED as a long position to the tracked portfolio. As with most public equities, in a scenario where COVID materially impacts the World and the markets into the Summer and Fall (or beyond), BNED will not be a good place to have money (as Craig Hallum helpfully pointed out *after* the fact in mid-March), and the portion of the tracked portfolio in gold will provide protection. With Morgan Stanley in place as advisor, BNED's strategic alternatives process will be an indicator of whether the M&A market is open for business today – at any reasonable acquisition valuation there is significant upside from today's price, conversely, if the M&A market is in a deep freeze we'll watch the BNED story play out with the luxury of a deeply discounted cost basis (in a paper portfolio context) and hopefully with the benefit of a moderating COVID crisis.

[11] Although acquisitions do flatter this picture somewhat and organic same store sales have been negative in recent years, however, the stability of the situation is much better than most retailers today.

ABOUT THE AUTHOR

Marcus Frampton, CFA, CAIA, FRM is the Chief Investment Officer of a ~$60 billion sovereign wealth fund. After graduating from University of California, Los Angeles in 2002 with major in Business-Economics and Minor in Accounting, Marcus joined the investment banking analyst program at Lehman Brothers. After three and half years at Lehman Brothers, he joined PCG Capital Partners, a San Diego-based private equity firm. Following his time at PCG and before his current role, Marcus worked for two years at LPL Financial focusing on M&A and other strategic investments for this Hellman & Friedman and TPG portfolio company.

Marcus currently serves on the Board of Directors of Scientific Industries, Inc. (OTC: SCND), Nyrada, Inc. (ASX: NYR), and the Managed Funds Association (the leading advocacy group for the hedge fund and managed futures industry).

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