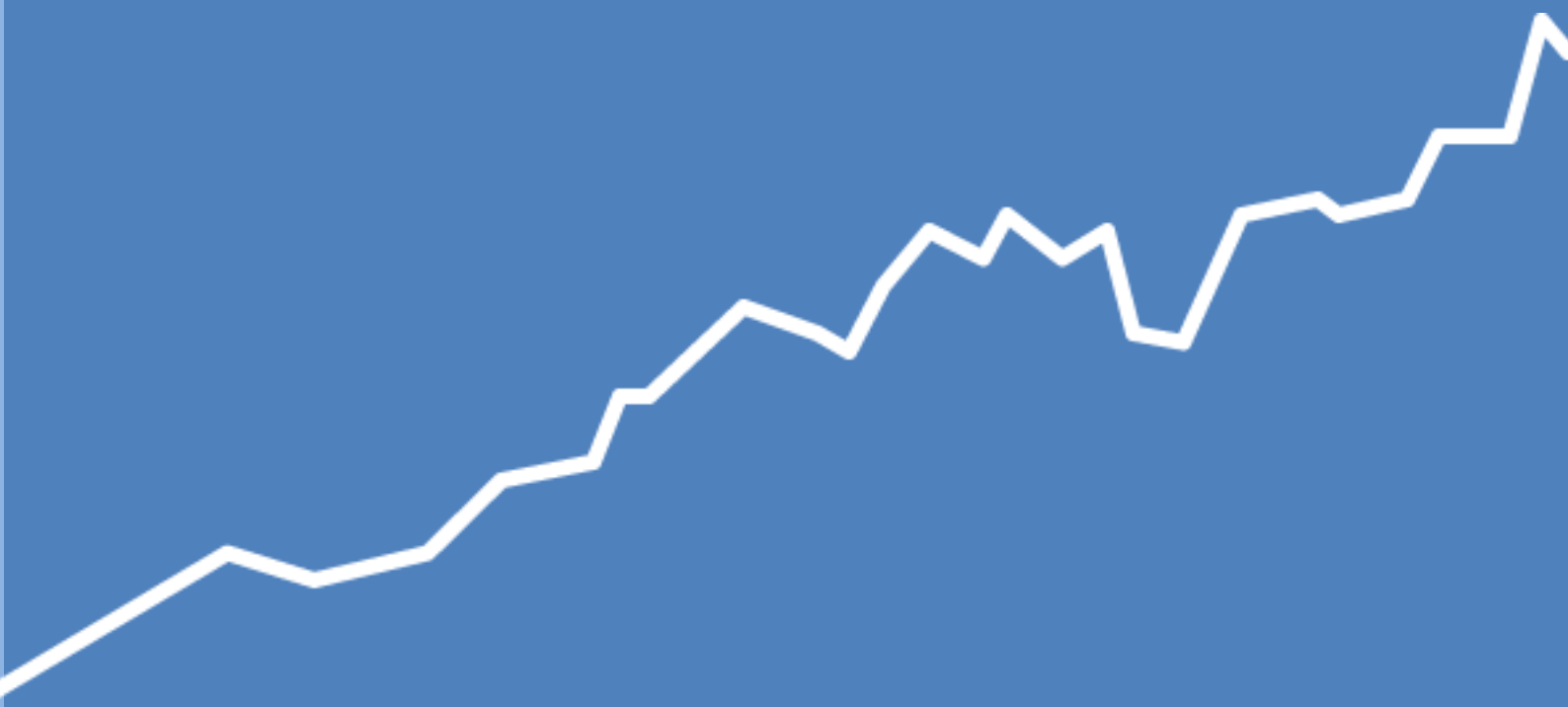
STOCKS 2015

SIX VALUE STOCKS FOR 2015 AND BEYOND



Nick Kraakman - ValueSpreadsheet.com

December 2014

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FOREWORD

December 2014

Dear investor,

In the report your are currently reading I will discuss 6 of my favorite stocks for 2015 and beyond. But let's start by taking a look at how the stock market performed in 2014 and if we can make some estimated guesses about the upcoming year.

Stocks performed extremely well last year. The S&P 500 rose 12% over the last 12 months, hitting an all-time high of 2075 points in December before dropping back a bit. The Dow Jones climbed 9%, and the technology exchange Nasdaq added an impressive 15%.

However, many indicators currently scream that the market as a whole is overvalued. For example, the Shiller P/E ratio, divised by Prof. Robert Shiller from Yale University, is currently at pre-crisis highs. That's why it was very hard to find great bargains for this report and means we should be extra careful when investing.

The selected stocks in this report all score well on the two key value investing factors of *great companies* selling at a *discount price*. In the long run, stocks with these characteristics tend to significantly outperform the market average.

Still, if a market correction takes place, which is not an unlikely scenario for 2015, these stocks will also take a hit. Therefore I suggest to keep part of your portfolio in cash at this moment so you are ready to jump in at lower prices. But whatever happens in the short run, the stocks you find in this report are likely to earn you a handsome return in the long run!

I hope you will enjoy the thorough analyses of my favorite stocks for the upcoming year and I wish you an amazing 2015!

With kind regards,

MSc. Nick Kraakman

Disclosure: of the stocks discussed in this report, Nick personally owns FHCO and CPA

COPA HOLDINGS, S.A. (CPA)

Price	$95.47	Net Earnings	$449 million
Market Cap	$4.23 billion	Price/Earnings Ratio	9.45
52 Week Range	95.17 - 162.83	Return on Equity	22.61
Dividend Yield	4.02%	Debt/Equity	0.54
Exchange	NYSE	Intrinsic Value	$160
Industry	Airlines	Upside potential	67%
Website	copaair.com	Max Purchase Price	$112

PITCH

A highly profitable South American airline company with unique geographical advantages and plenty of growth potential which is currently experiencing some temporary headwind due to political instability.

BUSINESS MODEL

The first company on the list might surprise you. Copa Holdings, S.A. (CPA) is a Panama based airline providing passenger and cargo services in Latin America. The company offers around 300 daily flights to more than 120 destinations from its Panama City Hub. In 2014 Copa's fleet consisted of 98 passenger aircraft with an average age of around 6 years, which is considered relatively young in the airline industry.

While Warren Buffett is known for seriously disliking airline companies, Copa possesses several unique advantages over its competitors, which will be discussed in detail later on. In addition, the company recently experienced a massive selloff due to political issues between Venezuela and Panama. This quarrel froze up $509 million in cash which Copa had stored in Venezuela.

While this is a big blow for the company, Copa has been one of the only companies in the airline industry to consistently earn money. In fact, the company multiplied its revenue 6-fold over the last 9 years and saw a 500% increase in earnings per share. Copa might just be the exception to the rule, an outlier.

FUNDAMENTAL ANALYSIS

As mentioned before, Copa possesses several unique and sustainable competitive advantages, of which many are of a geographical nature. For starters, Panama only charges Copa a 10% tax rate, while most of its competitors are taxed in the 35% or higher range. This has a powerful and continuous positive impact on their bottom line, which shows in their healthy 16.3% net margin versus the industry average of just 2.4%.

Besides, Copa controls 80% of the air traffic on the Panama City airport, which means the company can service North, Central and South America with little to no competition and is able to consolidate traffic, allowing them to service destinations which are uninteresting to competitors due to smaller demand. In addition, the economy of Panama has been growing fast and is expected to grow at 7% for the next two years at least.

Air traffic in the Latin America region is expected to grow at about the same pace, 6.9%, for the coming 20 years. The only region in the world that grows faster is the Middle East. The recent drop in fuel prices will also greatly benefit the company, since this expense accounts for a whopping 30% of revenue. The company's CEO, Pedro Heilbron, has been in charge since 1988. During that time the company has performed exceptionally well.

Over the last 10 years, Copa's Return on Equity has consistently been above 20%. Their debt/equity ratio of 0.54 is relatively low in the airline industry and has been getting lower over the years, which is a very healthy sign. On the other hand, the current ratio has been increasing to 1.3. While we prefer to see a current ratio of 2 or higher, 1.3 is still pretty good compared to an average current ratio of 0.89 for the airline industry as a whole. For those of you who like a steady dividend, Copa's 4% dividend yield might be interesting.

Copa's annual EPS growth rate has been around 25% for the last 5 years. However, analysts polled by Yahoo Finance expect a *negative* 1.75% growth for the next 5 years. This seems a highly unlikely scenario based on the analysis above. If we assume a still conservative 10% growth rate, the intrinsic value of Copa Holdings is estimated at around $160, implying a 67% upside potential from current price levels. All of the above mentioned factors indicate Copa has a bright future ahead!

RISK FACTORS

Obviously not all is fine and dandy with Copa Holdings. The current political instability between Panama and Venezuela is having a significant impact on the company. Not only does the company have several hundred million dollar parked in Venezuela, which they might or might not get back, but Copa might also have to replace some of their high-margin traffic to Venezuela with lower-margin destinations.

However, it is important to keep in mind that the risk of not getting any of their cash out of Venezuela is limited thanks to a hedging facility they've put in place. And the reduction in high-margin traffic will most likely lead to a decrease in net earnings of no more than 10%, which is much less than the 40% drop in price the company's stock experienced recently.

Still, it is likely that Copa's earnings will take a hit in 2015, but based on their strong cash flows and powerful competitive advantages, Copa seems like a great long-term bet if you are willing to take the political instability in South America for granted.

THE FEMALE HEALTH COMPANY (FHCO)

Price	$3.67	Net Earnings	$2.43 million
Market Cap	$105.76 million	Price/Earnings Ratio	43.64
52 Week Range	3.31 - 8.75	Return on Equity	37.9
Dividend Yield	-	Debt/Equity	0
Exchange	NASDAQ	Intrinsic Value	$10
Industry	Birth Control Products	Upside potential	172%
Website	femalehealth.com	Max Purchase Price	$7.00

PITCH

An undervalued, misunderstood micro-cap niche leader in the underserved female condom industry with a high-quality, patented product and a mission to rapidly expand their reach.

BUSINESS MODEL

The Female Health Company (FHCO) manufactures, markets and sells the only FDA and World Health Organization (WHO) approved female condom in the world, the FC2. The condom provides dual protection against unintended pregnancy as well as sexually transmitted infections (STIs) like HIV/AIDS. This revolutionary product gives women control over their own bodies, which is especially needed in third-world countries.

The FC2 is made of a patented nitrile polymer which prevents skin-to-skin contact during intercourse, and contains an internal and an external ring. The FC2 is non-allergic, pre-lubricated, can be used with both water and oil based lubricants, may be inserted in advance, and is currently available in 143 countries. The company's main clientele are NGO's and governments which make bulk purchases on an irregular basis, which explains FHCO's rather lumpy, but growing earnings.

Lumpy earnings and the discontinuation of dividends in favor of investments in future growth have resulted in a steadily decreasing share price, making this an interesting value stock at current price levels.

FUNDAMENTAL ANALYSIS

The competitive position of FHCO is strong, since their FC2 is the only female condom approved by both the FDA and the WHO. There are competitors, like the Cupid and the PATH, but the FC2 is the only condom which is non-allergic, pre-lubricated, can be used with both water and oil based lubricants and may be inserted in advance. FHCO's patented nitrile polymer can be produced at relatively low costs while they are able to ask premium prices, resulting in an incredible net margin of 45% and a return on equity of 51% in 2013 and a 5-year average return on equity of 37.9%.

2014 was a difficult year for FHCO, but still 9.7 million units were sold during the fourth quarter of 2014 alone, a 15% year-over-year increase. On top of that, FHCO recently won a tender offer to supply no less than 50 million (!!) FC2 condoms to the Brazilian government in 2015. It's easy to mistake lumpy earnings for bad results. The company also has an exceptionally strong financial position, with a current ratio of 4.3 and zero debt on their balance sheet.

FHCO used to pay a significant dividend, which they decided to suspend in July of this year, leading to a sharp price decline as dividend investors sold their shares. The reason the company gave for suspending their dividend payments was that they want to use the cash to market and grow their business. They put force behind this statement by hiring Susan Ostrowski and putting her in charge of Business Development.

The company has grown at 25% a year on average over the past five years, and there is no reason to believe the company will slow down in the near future, especially with their new focus on growth. The Brazilian government offer alone will propel the company back to 2013 profitability.

And if we assume that FHCO's earnings return to 2013 levels of $0.51 per share, and use a conservative 15% growth rate, we arrive at an estimated intrinsic value of around $10.00, which implies a 172% upside from the current share price of $3.67. This significant undervaluation is primarily caused by the fact that many investors look at the short run, which showed decreasing earnings in 2014, while forgetting about the bigger picture, which shows a steady upward earnings trend.

RISK FACTORS

The unpredictable, lumpy earnings produce wild price swings in this micro-cap company, which is what many investors would consider as a risk. However, volatility is not the same as risk, and these irrational price swings actually create wonderful purchase opportunities for the patient investor.

On the other hand, having all earnings coming from a single product and only a handful of rather big clients does pose a real threat. If one or two big clients decide to postpone their purchase or switch to a competing product, FHCO's earnings will take a massive hit. Fortunately, FHCO is aware of this and is taking action to diversify by developing new products and through attracting new clients by ramping up their sales and marketing efforts.

While the move towards more sales and marketing, at the expense of the dividend payout, seems like a smart long-term move for this ambitious company, there is no certainty whatsoever that this new strategy will result in increased earnings. In fact, there is not even much clarity yet as to what that new strategy will look like exactly. It is however important to keep in mind that there is a crucial difference between uncertainty and risk.

There is currently a significant lack of awareness of the existence and benefits of the female condom, which means there is still massive growth potential. The future of FHCO depends on their ability to spread the word and convince governments and large organizations to take action to protect the health of female citizens. Judging from Amazon reviews and initial studies in Brazil, it is at least clear that women are enthusiastic about the FC2.

KWEICHOW MOUTAI (600519)

Price	¥184	Net Earnings	¥14.76 billion
Market Cap	¥208.88 billion	Price/Earnings Ratio	14.24
52 Week Range	118.01 - 186.62	Return on Equity	33.82
Dividend Yield	2.22%	Debt/Equity	0
Exchange	Shanghai	Intrinsic Value	¥290
Industry	Beverages	Upside potential	57%
Website	Moutaichina.com	Max Purchase Price	¥203

PITCH

A highly profitable luxury liquor producer from China with a rich tradition and a strong moat, whose earnings and executives are currently under pressure from president Xi Jinping.

BUSINESS MODEL

Kweichow Moutai is considered one of the gems of the recently opened Shanghai Stock Exchange. This state-owned company produces and markets the premium Maotai liquor, as well as a host of other luxury beverages, among which the pricey baijiu liquor, which outsells vodka worldwide. Kweichow Moutai's products are marketed worldwide.

The company owns the entire valley around the Moutai town in the Kweichow region in China, where they have been producing their luxurious Moutai liquor for over 100 years now. And since the unique soil composition in the valley is what gives the drink its distinctive taste, it is nearly impossible for competitors to copy the Moutai liquor. And since the drink is so strongly linked with the region, China even decided to give Moutai a protected geographical indication (GI) status in 2012.

FUNDAMENTAL ANALYSIS

Kweichow Moutai is a company with several strong competitive advantages. First, their Moutai liquor has a long cultural history and is considered the national drink of China. Such a heritage is not easy to duplicate. Moutai is favored by the elite, which opens the way for premium prices and high margins, since not a lot of money has to be spent on research & development.

Second, the geographical protection of the Moutai brand means that competing products cannot use that name. However, it is nearly impossible for competitors to reproduce the Moutai flavor anyway, since the distinct taste is derived from the peculiar soil composition in the valley owned entirely by Kweichow Moutai. Still, there are some competing products, but the Moutai brand is strong and has a loyal following.

The liquor business is a relatively simple, understandable business with predictable earnings, just what Warren Buffett likes to see. Return on equity has consistently been above 30%, with net profit margins of 47% over the past 12-month period.

All of this is achieved without any debt, which goes to show just how profitable this particular line of business is. The company currently sports a 2.22% dividend yield. Add to that a current ratio of 5.06, and you have yourself a company with extremely strong fundamentals.

European based liquor behemoth Diageo, known for Johnnie Walker whiskey and Smirnoff amongst other drinks, is trading at a P/E of 21.02, compared to Kweichow Moutai's humble P/E of 14.24. It's a different continent, sure, but it does seem to indicate that Moutai is relatively cheap at the moment.

Absolutely speaking, based on the results of several valuation models, the intrinsic value estimate for Kweichow Moutai is ¥290. I used a 16% growth rate, which is 50% lower than the company's 5-year average, because the high-end liquor business is currently experiencing some headwind in China.

RISK FACTORS

While this sounds like a fairy tale so far, there are definitely some grim edges. One of the major risks facing the company are a slur of corruption charges against senior Kweichow Moutai executives on the grounds of "serious disciplinary violations". President Xi Jinping has been cracking down hard on corruption lately, which should be applauded, but which could have a negative impact on Kweichow Moutai. Still, even if an executive is found guilty, the punishment will most likely be temporary and manageable.

Besides corruption, the president of China is also on an anti-luxury quest, banning the company's $300 dollar a bottle baijiu drinks from official banquets since 2012. To compensate for the loss of this gigantic source of revenue, Kweichow Moutai halved its prices and moved much of their sales online. If this strategy will pay off remains to be seen.

Something worrying is the fact that for the past two years free cash flow has stagnated while earnings have nearly doubled. This is unsustainable in the long run and could even indicate that the company is manipulating its earnings. The corruption probe might shed some light on this situation. In general, Kweichow Moutai is not great at spending the cash they earn wisely, which means that it could actually lead to an improvement if one of the executives will have to be replaced.

TERRA NITROGEN HOLDINGS (TNH)

Price	$98.86	Net Earnings	$388.6 million
Market Cap	$1.83 billion	Price/Earnings Ratio	7.76
52 Week Range	90.55 - 173.50	Return on Equity	82.18
Dividend Yield	10.12%	Debt/Equity	0
Exchange	NYSE	Intrinsic Value	$245
Industry	Nitrogen Fertilizers	Upside potential	148%
Website	Cfindustries.com	Max Purchase Price	$171

PITCH

A "boring", immensely profitable producer of nitrogen fertilizer with an exceptionally strong financial position, lush dividend payments, and a significant probability of doubling in price.

BUSINESS MODEL

Terra Nitrogen Holdings (TNH) produces nitrogen fertilizer, which is used to supply essential nutrients to farmlands for optimal growth of plants and crops. It is estimated that without the use of fertilizers, crop yields would be 30 to 50% lower than they are today. According to research by the market intelligence firm Ceresana, the global fertilizer market will grow to more than $185 billion in 2019.

TNH's main fertilizers are ammonia based and produced in their Oklahoma production facility. In 2010, TNH was acquired for $4.7 billion by CF Industries Holdings, a large manufacturer and distributor of nitrogen and phosphate fertilizer, and is now a wholly owned subsidiary.

FUNDAMENTAL ANALYSIS

Warren Buffett loves "boring" businesses, because they often turn out to be underfollowed cash-cows, and it is hard to think of something more boring than fertilizer. However, once we dig into this industry a bit deeper, you might find that the profit potential is alluring to say the least.

There are several main types of fertilizer available, among which nitrogen, phosphate, and potash. TNH produces nitrogen fertilizer, which is a good thing, because the demand for nitrogen fertilizer has been growing at twice the speed of that of phosphate and potash. TNH is not the biggest player in the industry and has several competitors, but the fertilizer market is big and getting even bigger, as a growing world population combined with a limited availability of farmland demands higher per-area crop yields.

Just how profitable is the fertilizer industry? Well, TNH currently sports a ridiculous 82% return on equity, which is approximately equal to the 5-year average. The net profit margin of 36.9% is equally impressive, especially given the fact that the company employs not a single dollar of debt. Another indicator of a healthy financial position is the current ratio of 3.67, meaning the company will have no trouble paying its short term obligations.

Another great sign is the fact that free cash flows have been consistently higher than net income. On top of all this, the company has a beautiful 10.12% dividend yield. However, this yield fluctuates significantly over time. Also, dividends are only interesting if the company has no better use for its cash. In the case of TNH, so much cash is generated that dividend payments are warranted, although current yields seem a bit overdone.

Despite all of this, TNH has seen its stock price decline over 40% during the past 12 months. A bad harvest last year's season, lower ammonia prices and higher natural gas costs (an important input for nitrogen fertilizer) have put pressure on TNH's earnings. If any of these factors improve, in combination with the global growth trend of the fertilizer industry, TNH should have a great future ahead.

TNH is currently trading at a P/E of just 7.76, compared to the industry average of 17.6. Another sign of undervaluation is the fact that TNH's current market cap of $1.83 billion is less than half the $4.7 billion CF Industries paid for them in the 2010 takeover, even though earnings per share doubled between 2010 and 2013. Using the currently slightly depressed earnings and a conservative 6% growth rate, the intrinsic value estimate for TNH is $245, which implies the stock price could more than double. Even if we use an unrealistically low 1% growth rate, TNH's intrinsic value is still around $200. And this is excluding dividends!

RISK FACTORS

Before getting over-excited about this company, let's keep our feet on the ground by looking at some potential risks which could have a negative impact on profitability. The biggest, and most complicated risk is the partnership agreement with CF Holdings. The agreement leaves room for CF Holdings to transfer money from Terra Nitrogen Holdings to their own bottom line. This could get nasty when the wrong people have the authority to pull the trigger. This risk is particularly present in case CF Holdings starts to experience financial headwind.

Also, TNH has a history of fluctuating dividend payments, which can create a volatile stock price as dividend investors move in and out of the stock. But as mentioned earlier on in this report, volatility is not necessarily a risk, but can actually create opportunities to purchase at irrationally low price levels.

Natural gas is an important input for nitrogen fertilizers, and so production costs are closely linked to natural gas prices. If the price of gas increases, profit margins for TNH decrease. On the other hand, ammonia prices determine to a large extend the price TNH gets for their products. This exposure to unpredictable commodity prices could be seen as a risk, or merely as uncertainty.

Finally, there is always the risk of increased competition, especially because the fertilizer industry is so lucrative. There is already an increased supply of fertilizer coming from China. A drop in demand seems unlikely, given the growing world population. If anything, demand will most likely increase significantly over the coming years.

INTERNATIONAL BUSINESS MACHINES (IBM)

Price	$155.38	Net Earnings	$12.72 billion
Market Cap	$153.77 billion	Price/Earnings Ratio	9.76
52 Week Range	155.33 - 199.21	Return on Equity	69.98
Dividend Yield	2.83%	Debt/Equity	3.21
Exchange	NYSE	Intrinsic Value	$230
Industry	IT Services	Upside potential	48%
Website	Ibm.com	Max Purchase Price	$161

PITCH

A consistently profitable mega-brand in the software and IT services sector which is selling at a discount and is returning serious value to shareholders through aggressive share repurchases and dividends.

BUSINESS MODEL

International Business Machines, better known as IBM, is one of the oldest and largest IT companies in the world. Ever since the company decided to sell its hardware division a couple of years ago, its 400.000 employees have been primarily active in business-to-business software development and consultancy services. Rather lucrative segments of the technology market. This strategic shift has significantly improved profitability.

Despite the sheer size of the company, IBM is highly innovative and has been granted the highest number of patents of any company in the world for several years in a row now. IBM is big in big data, cloud computing, machine learning, and other high-tech areas. The company has outsourced a significant part of software development to lower wage countries like India.

These cost reductions, higher profit margins, and large and consistent share repurchases have resulted in a steady earnings per share growth over the last decade. Both Warren Buffett and Joel Greenblatt own shares of this financially strong cash cow. Recent price pressure due to disappointing Q3 earnings has turned this stock into an interesting value pick.

FUNDAMENTAL ANALYSIS

When it comes to competitive advantages, IBM has several. First, IBM is the world's fifth most valuable brand according to Forbes, just behind Coca Cola, and the company's 100+ years of history are filled with innovation and remarkable achievements. IBM has genius, elaborate and highly effective marketing campaigns to promote its brand and services, like IBM Deep Blue beating chess champion Garry Kasparov and IBM Watson beating the best Jeopardy players in the world. Two events which got massive media coverage hailing the technological prowess of IBM.

Second, the constant stream of cutting-edge research coming from IBM has given them a massive intellectual property advantage. The company is able to license their colossal patent database to large corporations in return for attractive fees. Besides having dedicated researchers, there is an entire incentive system in place which encourages every employee with an idea to file their patent under the IBM flag. Finally, outsourcing, as well as economies of scale and scope, give this giant significant cost advantages.

IBM has been increasing its debt levels over the past couple of years to, amongst other things, return value to shareholders by buying back shares and paying dividends. This debt distorts the return on equity figure, so we will look at return on capital instead, which has been consistently high over last decade and is currently at a solid 22.6%. The 13% net profit margin has been fairly stable over the years. The current ratio of 1.11 is definitely not great, but with a whopping $13 billion in free cash flow coming in each year and nearly $10 billion in cash on hand there seems to be little to worry about.

While revenue growth has been minimal, which is not unusual for a company as big as IBM, there has been a steady increase in earnings per share thanks to an aggressive share repurchase program. The 2.7% dividend yield is another way the company returns value to shareholders. Despite all of these great efforts, the stock price has hardly moved during the last three years. Recently, disappointing Q3 earnings lowered the price back to 2011 levels, even though IBM has signed several billion dollar deals lately.

IBM's current P/E ratio of 9.76 might seem low, especially in the technology sector, but we also have to take into account the fact that a large company growing at the snail pace IBM is growing at is usually valued at a lower multiple. Still, using a conservative 5% growth rate, the intrinsic value of IBM lies somewhere around $230, which mean a 48% upside potential from current levels.

RISK FACTORS

As mentioned before, IBM's top line growth is slowing down, nearly grinding to a halt actually. While this is not altogether strange for a huge company like this, it is definitely worrisome. It seems that despite the constant stream of innovation coming from their research facilities, they are unable to turn this into extra sales. Coming up with great ideas and capitalizing them are two radically different things.

Another common threat to technology companies like IBM is the ever increasing competition, for example from Cloudera in the cloud computing space, or Accenture and similar companies on the consultancy side. It's a so called Red Queen race, where the environment is changing so quickly that a company has to keep running in order to stand still. However, it will not be easy for competitors to claim IBM's throne as the leader in the field of high-tech research and services.

On top of this, IBM's ever increasing debt levels pose a serious concern. Debt/equity is currently at a 10-year high of 2.3. This creates serious interest rate risks and creates a more risky financial situation. IBM uses this debt mainly to repurchase shares, because that's cheaper than using their own cash reserves over which they first have to pay taxes. Apple (AAPL) is doing the same thing, so it's not an uncommon practice. IBM just has to be very careful not to let their debt get out of hand.

PHARMA-BIO SERV (PBSV)

Price	$1.25	Net Earnings	$2.81 million
Market Cap	$29.73 million	Price/Earnings Ratio	10.51
52 Week Range	0.80 - 2.12	Return on Equity	15.20
Dividend Yield	-	Debt/Equity	0.01
Exchange	OTC	Intrinsic Value	$2
Industry	Compliance Consultancy	Upside potential	60%
Website	Pharmabioserv.com	Max Purchase Price	$1.40

PITCH

An under-the-radar, nano-cap, compliance consultancy company with an extraordinarily strong balance sheet and plenty of growth prospects selling at a large discount to intrinsic value.

BUSINESS MODEL

For over 20 years, Puerto Rico based Pharma-Bio Serv (PBSV) has helped large pharmaceutical, chemical, medical, and biotechnology enterprises around the world to successfully navigate their often complex and strictly regulated markets. The company offers compliance, risk-management, knowledge-management, consultancy, laboratory testing, and HR services. This broad range of services allows Pharma-Bio to be a one-stop-shop for their clients.

Despite its tiny $29 million market cap, this company has durable relationships with most of the major players in the above mentioned industries. The company is active in Puerto Rico, the United States, and Europe, with most of their current growth coming from the US. Besides their core business, the company also serves clients in the cosmetic and food industry. In 2004 Pharma-Bio Serv was incorporated and is currently trading on the OTC market.

FUNDAMENTAL ANALYSIS

Thanks to their 20-year track record, Pharma-Bio Serv has established a dominant market position in Puerto Rico, their home base, as well as strong relationships with many of the biggest companies in the pharmaceutical, medical, chemical, and biotech industries. The company has become the recognized expert in the field of regulatory compliance and project management. Such a heritage is not easy to replicate by competitors and can therefore be seen as a competitive advantage.

Looking at the financial statements, we see a rather volatile earnings history. The reason for this is that Pharma-Bio Serv works on a project basis. So if several big projects end in a given year, earnings will take a significant hit. It is therefore important to look at the long-term average growth, rather than year-over-year earnings per share growth. Despite volatile earnings, book value has grown close to 40% a year over the past five years, which is a strong indicator that the company is creating serious value.

The company uses virtually no long-term debt and has seen its current ratio increase to an impressive 9.3 (ttm). Combined with an Altman Z score of 8.82, it seems nearly impossible for any serious financial troubles to occur in the near future. A wonderful 51% insider ownership ensure that the interests of the company's management are closely aligned with the interests of shareholders. Their relatively small size makes Pharma-Bio Serv flexible to quickly adapt to changes in their industry.

2011-2013 was a great period for the company, with net margins around 15% and return on equity of 30% and higher. The current fiscal period is showing rather disappointing earnings, which is why the stock price dropped 40%. Of course this drop in earnings can be partially explained by the cyclical nature of their project-based business model. So is Pharma-Bio Serv cheap?

Well, it is not easy to value a volatile business. A P/E of 10 and a price/book ratio of 1.5 hint at undervaluation, but we can't rely on these metrics alone. Using several intrinsic value models and a very conservative 10% growth rate, compared to the 40% annual book value growth rate, Pharma-Bio Serv should at the very least be worth $2, the price of early 2014, which implies a 60% upside from current levels.

The company recently announced a significant share repurchase program, which would reduce the total shares outstanding by 9% and could function as a catalyst for price appreciation. In addition, Pharma-Bio Serv is growing nicely in the US and is starting to get traction in Europe. These facts further illustrate how conservative the 10% growth rate used to calculate the intrinsic value is. It would not be surprising to see the stock reach $2.50 or higher within a couple of years.

RISK FACTORS

Of all the stocks mentioned in this report, Pharma-Bio Serv is probably the most risky one. And not just because of its tiny market cap, its highly volatile earnings, and its thinly traded stock.

The fact that more than 50% of revenue comes from just 3 major clients is a serious risk. If any one of these clients decides to switch to a competitor, a large chunk of revenue is gone. However, because Pharma-Bio Serv works on a project-by-project basis, the loss of a big client will usually only impact a single year as new projects from new clients fill the gap.

In general, South American countries like Puerto Rico tend to experience somewhat unstable political situation from time to time. While this might or might not become an issue in the future, the current situation seems to have little impact on the company. Their expansion abroad further reduces this risk.

While it seems unlikely, there is the risk that the current drop in earnings is an indicator of long-term fundamental problems with the company instead of just a result of lumpy earnings. At least the CEO of Pharma-Bio Serv did not inspire a lot of confidence and positivism in her latest address. Therefore caution is advised and conservative estimates are essential.

BONUS #1: TEXAS PACIFIC LAND TRUST (TPL)

Price	$120.54	Net Earnings	$34.05 million
Market Cap	$1.01 billion	Price/Earnings Ratio	29.85
52 Week Range	93.00 - 242.00	Return on Equity	155.18
Dividend Yield	0.22%	Debt/Equity	0
Exchange	NYSE	Intrinsic Value	$78
Industry	Property, Oil & Gas	Upside potential	-
Website	Tpltrust.com	Max Purchase Price	$55

PITCH

A one-of-a-kind perpetual cash machine hardly anyone has ever heard of with a unique business structure, extreme profitability, virtually no costs, and a responsibility to return *all* of its returns to shareholders.

BUSINESS MODEL

Texas Pacific Land Trust is a highly unusual company hardly anyone has ever heard of which started trading on the NYSE in 1888. Yes, that is a looong time ago. A couple years earlier, the Texas & Pacific Railroad company went bankrupt and their debtholders received the ownership of 3.5 million acres of Texas desert. They decided to slowly sell off this land over time, and to this end they established the Texas Pacific Land Trust. Remember, this was before oil was discovered in Texas…

Today the Trust still owns around 900.000 acres of land which they continue to sell. In addition, revenue is generated from oil and gas royalties, grazing leases, easements, and sundry and specialty leases. Essentially, the company earns money without really doing anything. By Charter, they *have* to return *all* of the proceeds to shareholders and primarily do this through share buybacks and dividends. They have done so for over 120 consecutive years now.

FUNDAMENTAL ANALYSIS

This company is so unusual that it requires a special approach when analyzing it. The company is one of a kind, so there is little use in looking at competitors and competitive advantages. Basically, the company consists of eight employees, a bunch of land, and a Charter which dictates the overall business strategy.

While the objective of the Trust is to sell all the land, most income is in fact generated from oil & gas royalties, totaling $7.7 million in the most recent quarter alone. These royalties have lately seen a significant increase in value (+67% from 2012 to 2013) as new drilling techniques like fracturing have ramped up oil production. And more oil equals more money for the Trust, which is why Texas Pacific Land Trust is in no rush to sell.

The 155% return on equity and 62% net margin are testament to the unique structure of this company. In 2013, Texas Pacific Land Trust reported record earnings of $27 million, but over the past twelve months net income climbed even further, reaching the $34 million mark. This strong performance has pushed the share price up more than 500% over the last 5 years.

The company is constantly buying back shares, around 300.000 a year on average, and there have been years in which more than 4% of its shares were repurchased. These share repurchases act as a tax-free dividend. On top of this, the company also pays an actual dividend. Taxes are the biggest and almost only serious costs the company has besides general and administrative expenses.

Land sales represented 14.5% of revenue in 2013. The price the Trust receives per acre of land it sells varies significantly, since some pieces of land are obviously more valuable than others. In 2013, the average price paid per acre was $616. With 899,579 acres remaining in November 2014, this amounts to a land value of $554 million. The Trust generated $33.88 million in free cash flow over the last 12 months. At a reasonable multiple of 8 times free cash flow, this amounts to $271 million.

Adding the land and the cash flows, applying a 20% margin of Safety, and dividing by the number of shares outstanding, we arrive at an intrinsic value estimate for Texas Pacific Land Trust of $78 per share. At a current price of $120.54 and a P/E ratio of 29.85, it is clear that this underfollowed, one-of-a-kind cash machine is currently significantly *over*priced. I recommend you put this stock on your watch list and jump in once prices reach more reasonable levels again.

RISK FACTORS

With 126 consecutive years of positive earnings, and perpetual royalty contracts as their main source of income, this stock is as safe as it gets. Nevertheless, the recent drop in oil prices negatively affect the royalty income of the Trust. This has already resulted in a 45% price drop from the recent all-time high of $222, but the stock is still massively overpriced.

BONUS #2: VALUE INVESTING BOOTCAMP DISCOUNT

Hi!

I hope you enjoyed the analyses in this report! It was a pleasure putting this together for you and I'm convinced these stocks will strengthen your portfolio.

A new year is about to begin, and this is a great opportunity to make a commitment to improve your financial situation. To help you turn 2015 into your **most profitable year ever**, I want to offer you an **end-of-year discount** for my overcomplete *Value Investing Bootcamp* video course.

The course contains over 4 hours of **quality video content**, as well as quizzes, eBooks, case studies and spreadsheets. You can start the course as an absolute beginner, and at the end you will be a **Value Investing expert** with the confidence to manage your own portfolio. You'll be able to write your *own* stock analyses!

The regular price is $197, but if you decide **before January 15th** you can join **2386 satisfied students** for just **$97**! That's right, a *50%* discount! Even if you later decide it's not for you, you can get 100% of your money back with no questions asked. So invest in yourself and make 2015 your **best year ever** !

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Data: data in this report has been retrieved on 15-12-2014 from several sources, including GuruFocus, Google Finance, Morningstar, and Yahoo Finance. Data can differ between these sources.