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# The Micro Cap Investor

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*Strategies for Making  
Big Returns  
in Small Companies*

**RICHARD IMPERIALE**



**WILEY**

John Wiley & Sons, Inc.



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# Preface

This book is an explanation and analysis of micro cap stocks. These very small companies have endured a checkered history. In general terms, micro caps are large in absolute numbers but historically have been a small and misunderstood sector of the investment landscape. In this world of efficient markets and index funds, this perception has started to change. Many micro cap companies are well-managed, high-quality businesses that present an excellent investment opportunity. In addition, micro caps are a viable and competitive investment option for those who are looking to broaden and diversify their investment portfolios.

As a professional investor in micro cap stocks, I noticed that the average investor largely misunderstands these companies. Many professional investors and portfolio managers also have little knowledge or interest in micro caps. In addition, there are very few books or other resource materials on the subject of micro caps. Those books that are available are either very simple overviews of the subject or highly complex academic treatments of the topic. And most books do not address the fundamental research issues that underlie the basics of micro cap investing nor do they address the concept of how to integrate micro caps into an investment portfolio.

*The Micro Cap Investor: Strategies for Making Big Returns in Small Companies* is an attempt to address these very issues. The book begins by defining micro caps and reviewing why micro cap investors might be in a position to gain an information advantage. This is followed with a general discussion of micro caps as an asset class, an analysis of how micro caps behave as an investment class, and an explanation of how they are best integrated into an investor's portfolio.

The next three chapters of the book describe the fundamental economic issues that affect micro caps in general and attempt to analyze these issues in the context of the micro cap investment vehicle. The book continues with a series of case studies and a review of specific methods for analyzing and screening for micro cap investment opportunities. The final three chapters of the book use the theoretical constructs developed in the case studies to build a framework for investor action as well as reviewing the growth of PIPES, or private investments in public equities, a new capital financing opportunity for micro cap companies.

Micro caps are an emerging asset class. As in any new asset class, there is a limited amount of quality data available from which to draw conclusions. This book offers a practical and useful overview of the limited data that bridges theoretical constructs with practical investment knowledge. In addition, the book provides the reader with some practical statistical data relevant to the general analysis and valuation of the micro cap asset class. This appears in the numerous charts, tables, and graphs that summarize key micro cap data into a usable format.

My intention is for this book to fill a void in the available current literature about micro cap investing and to help supply a better understanding of an emerging asset class.

Richard Imperiale  
Milwaukee, Wisconsin  
September 27, 2004

# Acknowledgments

Although the author ultimately gets credit for writing a book, there is an army of others who contribute to the process. I'd like to recognize them here.

This book is dedicated to my wife, Sue, and our two daughters, Emily and Mary, who put up with my absence at family and school functions and during many evenings and weekends. Their support and encouragement made the completion of this project possible. Every day they make me realize how fortunate I really am.

I'd like to thank my good friend and mentor, Dr. John Komives, from the Marquette University Business School. For the past 20 years we have worked together with a great sense of adventure on many business and academic projects. We have often discussed potential projects over a cold glass of beer on Friday evenings and this book is in part a result of those conversations.

Of course, it's not a book without a publisher. My friend and colleague Jerry Twedell, who is the author of several investment books, was kind enough to introduce me to his publisher, John Wiley & Sons. Through that introduction, I met David Pugh, who is now my editor at Wiley. In the middle of a less than favorable general investment climate, he was open-minded enough to listen to my ideas about micro caps, give me critical feedback, and go to bat for me on this project. David has been an excellent coach and critic, who helped me shape this book into a much better and more useful text. I now consider him a good friend and thank him for all his help.

I thought the writing was hard. But that was easy compared to the copyediting. For helping me get through that phase of the project I want to thank Ginny Carroll. When the writing was finally

complete, the book was behind schedule. Ginny's talent and skill helped to get the project back on schedule. Through the editing process she also patiently taught me many useful lessons about editing and publishing that will make me a better writer in the future.

Much of the data in the book is compiled from academic papers, company reports, and industry trade associations. Much of that data was processed by my assistant, Rochell Tillman, and my research associate, Farid Sheikh. Their diligence and hard work have helped to provide consolidated data not found in any other single place.

I'd also like to thank Lyn Woloszyk, who transcribed many of the chapters and case studies for the book. She often did the transcriptions on short notice and with tight deadlines, which was helpful in keeping the project on schedule due to my time constraints. And thanks to my business partner, Ed Jones, who covered for me at many meetings and on many projects while I was working on the book.

My sincere thanks to all of you.

## CHAPTER 1

# Characteristics of Micro Cap

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This chapter will attempt to answer the following questions:

- What is a micro cap stock?
- Why do they exist?

### **THE NEBULOUS MICRO CAP (WHAT IS A MICRO CAP STOCK?)**

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Investors often refer to “the market” when speaking about stocks as a group. However, knowledgeable investors will agree that not all stocks are created equal. Different investors will often focus on more narrowly defined segments of the market. When looking at the composition of the market as a whole, these investors will normally classify stocks by certain characteristics. The two most fundamental characteristics of classification within the investment community are those of value and of growth stocks. Most investors are familiar with the concepts of growth and value investing, although agreeing on the definition of either is often a topic of debate among informed observers.

Taken further, the growth and value styles can be divided into