Investors Alley

June 2015 Vol. 1 Issue 12

Bret Jensen's Small Cap Gems

Investing When We're Getting Mixed Signals

Fellow Investor,

The markets continue to trade in the same fairly narrow trading range that it has been for the last three months. Equities managed to squeeze out slight gains but are showing no inclination to break out decisively on the upside above current resistance levels.

Late in the month Q1 GDP was revised down to a negative 0.7% from the original reading of a paltry 0.2% annual growth to show a contraction in the opening stanza of the year. There was as expected plenty of hand wringing about winter and seasonal adjustments as a result. However, with second quarter growth projections currently hovering at just two percent it appears the first half of 2015 will show the slowest six months of economic activity since 2011.

In This Issue

iRobot (IRBT) 3

IntellipharmaCeutics Intl (IPCI) 6

Portfolio Update 9

Portfolio Standings 10

Closed Positions 11

Economic growth should pick up in the second half of 2015 but I still expect overall GDP growth to come in the same anemic 2% to 2.5% range it has throughout this weakest post war recovery on record. The IMF and others project that GDP would finally grow at an above trend rate of 3.5% at the start of the year seem ready to be thrown in circular filing cabinet.

The game of chicken continues in Europe with the latest debt installment in Greece. The market seems to be taking this in stride as it has seen this movie many times over the past few years. However, if no progress is made soon, this has the potential to cause some turmoil in our markets in the near future. After ebbing for a few weeks, the dollar has started to strengthen against the Euro again. I would not be surprised to see the greenback reach parity against its European counterpart by year end. This will continue to be a headwind to profits for American multi-nationals.

In addition, late in the month Chinese shares had one of their worst sell-offs of 2015 as some of the speculative excess starts to come out of equities in the Middle Kingdom. The Chinese stock market has been one of the best performing in the world in the six months or so that the country introduced a stock link to Hong Kong, and some pull back was overdue.

On a brighter note, the housing market seems to be perking up despite the highest 30 year mortgage rates of the year, albeit still under four percent. April pending home sales and actual new home sales came in above expectations. If we could see a sustained bounce in housing activity it would go a long way to improve my outlook on the domestic economy.

As we move through June I expect trading volume to remain low as the market struggles to find direction. I would not be surprised to see equities continue to be unable to break out on the upside given current valuations until we start to see better earnings and economic growth.

Although I not sanguine on the market over the next few months, I am still finding some values in the small cap space. This month we bring you a manufacturer whose products most are familiar with and a small biopharma play that recently has had some positive catalysts.

And this month we're closing two of our long standing positions. Both have modest gains but show no inclination of moving much higher in the near term and face some pretty stiff headwinds. We're cashing out on these two and taking our gains to redeploy them elsewhere. They're covered in greater detail in the Portfolio Update section of the newsletter.

If you live in Northern California or just need an excuse to visit San Francisco please come by the MoneyShow from July 16th through July 18th to see me and my Investors Alley colleague, Tim Plaehn, give presentations on a variety of topics including MLP investing, biotech investing, finding high growth stocks and more. Registration is free and I always love meeting up with subscribers at these shows, just as I did at the recent one in Las Vegas. **CLICK HERE for more information**.

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

Thank you and Happy Hunting.

Bret Jensen
Editor
Bret Jensen's Small Cap Gems

P.S. In late June I plan to officially launch my new *Biotech Gems* service to the public. In mid-May we beta published our first issue and took on subscribers. There have been a few requests to open up the service to *Small Cap Gems* subcribers before going fully public with it. If you're interested in being a beta tester and early subscriber **just click here for a short description of the service and a link to sign up**.

iRobot

Our first pick for this month's Small Cap Gems issue is a small niche manufacturer that is seeing revenues surge in the low teens annually and should achieve over $1 billion in annual sales in the next few years. The company is **iRobot (NASDAQ: IRBT)** and is best known for its Roomba vacuum. This unique device is quickly being adopted in more and more households. This includes mine where it is almost a necessity given I have a golden retriever who consistently sheds hair.

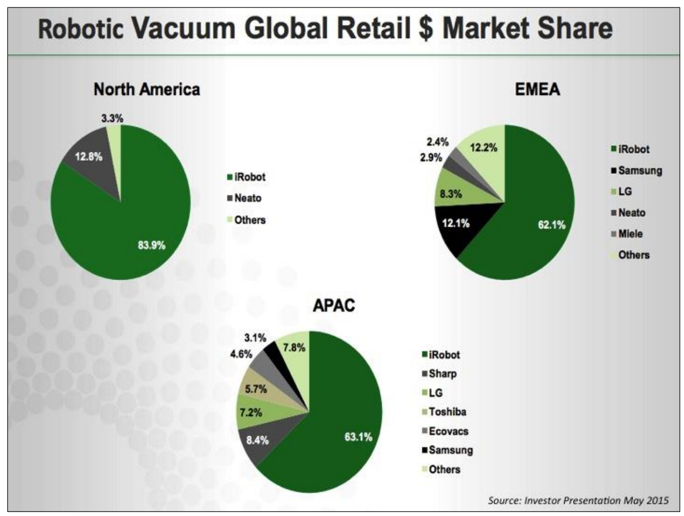
In a fast-paced technology environment, being the first to the market can lead to snapping up market share. The company has hit the ground with a cutting edge capabilities that should keep the it ahead of competitors. The robotics industry, despite solid growth, is often overlooked in favor of the better known smartphone, computer and software industries within the technology space. iRobot is a firm that's defined its niche in robotics by creating unique product solutions for home maintenance, defense and security, and remote presence.

The company was founded in 1990 by a team from the Massachusetts Institute of Technology. Let's break down the three separate market segments the company serves before discussing its financial performance.

Home Robot Opportunity:

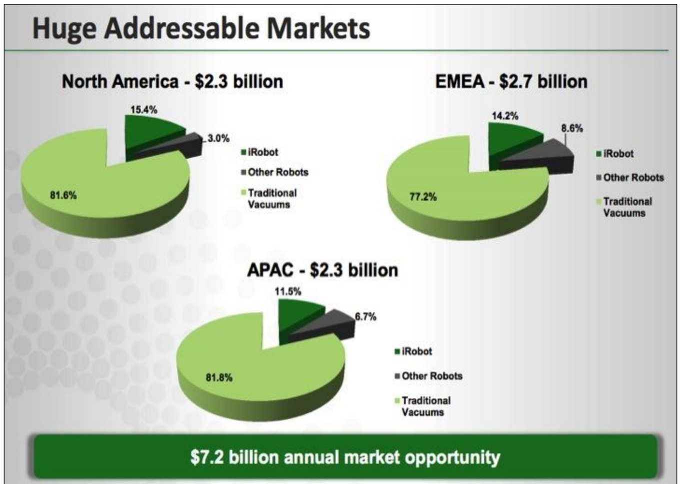
This sector focuses on cleaning up the home with an automated floor scrubbing robot, an automated floor mop, a pool cleaning robot and even a gutter cleaning robot. The most effective and popular home product is the before mentioned Roomba, a vacuum cleaner that is virtually maintenance free and autonomous. Each device utilizes impressive navigation technology to build out and remember a map of your room internally so that it can clean automatically without human guidance, improving the rate and quality of each subsequent cleaning. In short, it is a learning device unlike my golden retriever.

Tiny in size, the Roomba can navigate from room to room, return to its docking base to automatically charge, and can be set on a cleaning schedule. Thanks to its features, ease of use, and effectiveness, iRobot's Roomba line has captured over 80% of the robotic vacuum in the fast growing market in the U.S.



iRobot has firmly established itself as one of the original players in the home maintenance robotics market. The vacuum segment has performed consistently and helped anchor the firm's revenue over the years thanks in part to this first-mover advantage. Driven by growth in China and the US, Home Robot revenue is expected to grow around 12% in 2015.

If iRobot can continue innovating and improving its products then I expect it will steadily eat away at the traditional vacuum cleaner's market share. This shift has already begun: as a percentage of the overall vacuum market, robotic vacuums have increased from about 15% to 20% since 2011. A large addressable vacuum market of about $7 billion dollars still remains untapped, and iRobot has the opportunity to steal away these customers with its superior functionality and effectiveness. As importantly, the company has higher price points and margins than a regular vacuum, the byproduct of building a better mousetrap.



Source: Investor Presentation May 2015

Other Market Segments:

The company also sells a Defense and Security (D&S) line of robots designed for protection, productivity, and mission effectiveness. On one end of the D&S line of products is the iRobot 110 FirstLook, which is designed to deploy swiftly and provide eyes, ears, and situational awareness to its operators in an area deemed too unsafe for a person. On the other end of the spectrum is the 510 PackBot, which can perform bomb disposal, hazardous materials handling, and surveillance. This will an increasingly important part of iRobot's business going forward.

iRobot's tactical robots have been deployed for the safe detonation of devices by the military in the Middle East and Bomb Squads in the U.S. Around 70% of revenue in this business line has come from providing support services to previous customers. In the second quarter of 2015, D&S revenue is expected to be more than double that of Q2 2014 as a result of a Canadian contract won last year. Aside from the Canadian contract, the firm has indicated that it has a solid pipeline of opportunities from the Department of Defense and international customers.

The firm's Remote Presence business is an emerging product line that combines autonomous navigation and mobility with video conferencing. Ava 500 is a telepresence robot designed to facilitate face-to-face meetings in the corporate world via video conferencing. An entire line of "telemedicine" robots enable doctors to deliver care through remote consultations, with the RP-Vita model cleared by the FDA and HIPAA compliant.

iRobot recently installed multiple Ava 500s at Fidelity Investments' center in Boston for various applications including collaboration and tours for internal and external customers. The firm's Remote Presence segment is definitely more of an emerging business line than its well-developed D&S and Home Robot sectors, so I will look for sales bookings with large firms like Fidelity as a sign that this technology is gaining traction. iRobot is also interested in pursuing creative ways to partner its autonomous Ava platform with other firms to develop solutions to the communication needs of individual companies or industries.

Financial Performance:

First quarter results in 2015 exceeded expectations, with quarterly earnings of $0.16 per share beating the Zacks consensus estimate of $0.11 per share. Revenues improved from $114 million in the first quarter of 2014 to $118 million in the same quarter this year. Defense and Security revenue increased an impressive 17% year-over-year. Domestic home robot revenue was flat compared to last year, but only because domestic revenue jumped 31% from sales of a new vacuum model in the first quarter of 2014. Revenue in Europe, the Middle East, and Africa rose 20%, and revenue in China doubled.

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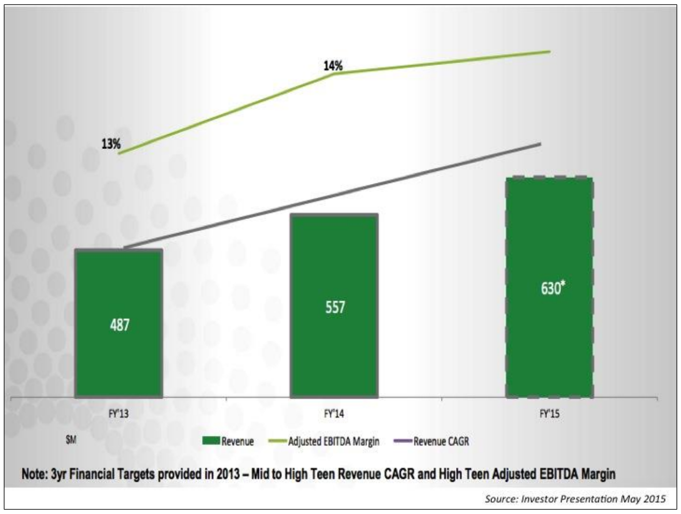
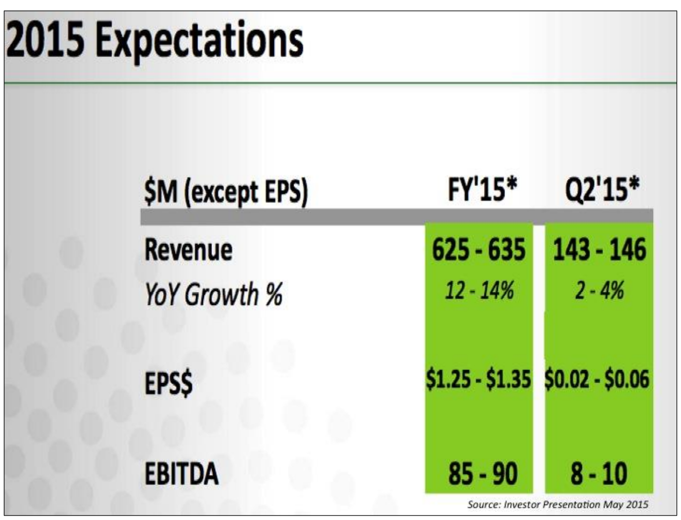


The company recently announced a $50 million buyback program through April 2016, and ended the first quarter with a sizeable $221 million in cash with is approximately 25% of the company's total stock market capitalization. The buyback would retire approximately six percent of outstanding float at current prices. iRobot has grown revenues consistently for several years now. Guidance for 2015 indicates that the firm should once again experience year-over-year revenue growth between 12% and 14%.



2015 Expectations

$M (except EPS)	FY'15*	Q2'15*
Revenue	625 - 635	143 - 146
YoY Growth %	*12 - 14%*	*2 - 4%*
EPS$	$1.25 - $1.35	$0.02 - $0.06
EBITDA	85 - 90	8 - 10

Source: Investor Presentation May 2015

Second quarter revenue is estimated to come in around $144 million, and the firm's business pipeline appears strong, particularly in the D&S segment. iRobot management recently indicated in its most recent earnings call that it expects just under 60% of revenue this year to be generated in the second half of 2015. This gives investors an opportunity to build a position before acceleration of growth in the last six months of the year.

Eight analysts that cover the firm have placed a median price target of $39.00 per share on iRobot, which currently trades just under $32.00 a share. Earnings will be relatively flat this year but should jump 20% to 25% next year to roughly $1.60 a share. Equating for the net cash on the balance sheet, and the stock trades at 15 times next year's earnings; a slight discount to the overall market multiple.

Given the company's domination of the home robot vacuum market, expanding opportunities in other markets, revenue growth and important niche technology the stock should be trading at least a slight premium to the overall market. With a market capitalization of under $750 million once cash is accounted for, iRobot would make an interesting and easily digestible purchase for a larger player interested in the company's technology and end markets. The stock feels 25% undervalued here in an overbought market.

Recommendation: Buy IRBT up to $34.00 a share with a preliminary price target of $40.00 a share.

Position: Long IRBT

IntellipharmaCeutics International

Our second addition for this month's edition of Small Cap Gems is a small biopharma company with under a $100 million market capitalization called **IntellipharmaCeutics International (Nasdaq: IPCI).** Despite its small size, the company is starting to gain the attention of some analysts and making progress with its main drug candidate. The company is focused on producing drugs that work better within the body.

Controlled-release pharmaceutical products that take advantage of technology advances to change the way prescription drugs are delivered in the body. The release of a drug at a target site, over an extended period of time or at a predetermined time, can help improve efficacy and patient compliance with dosing instructions. IntellipharmaCeutics International is a promising company whose technology targets the controlled-release drug market.

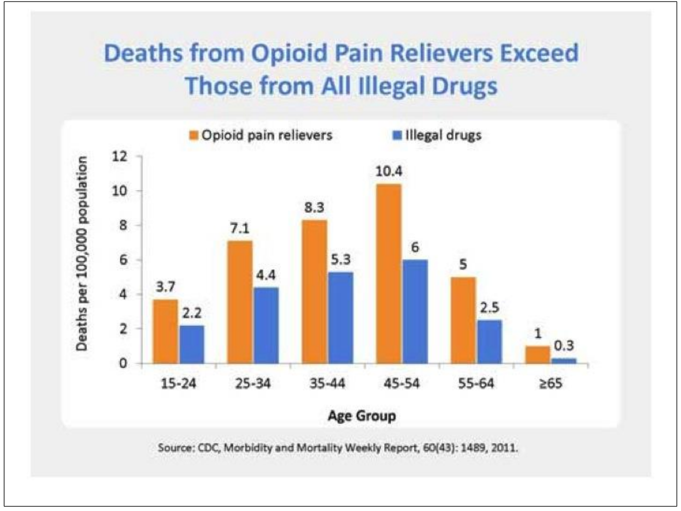
IntellipharmaCeutics' already possesses one revenue-generating product and a stable of products under FDA review. Analysts are excited about an abuse-resistant treatment for pain relief the firm is developing, which could help solve the epidemic of prescription painkiller abuse that has risen across the country in the last two decades.

Rexista Oxycodone XR:

As the firm's key non-generic product, Rexista's formulation aims to make intentional abuse nearly physiologically impossible while still effectively managing moderate to severe pain. The extended release component of the drug candidate helps prevent dose dumping, which is the rapid release of an active ingredient into the blood stream that can result in increased toxicity, side effects, and a loss of efficacy. Dose dumping can result by consuming a drug through crushing, vaporizing, injecting, or with alcohol.

Rexista has shown to be difficult and time consuming to syringe or inject for intravenous administration, and difficult to snort or inhale when crushed into particles. When crushed or pulverized and hydrated, the drug is designed to clot up in a hydrogel, which should prevent syringing, injecting, and snorting. The release of oxycodone should be insignificant via heating and vaporization, and no dose dumping should occur in the presence of alcohol. Rexista is designed to help prevent overdoses from occurring.

The company possesses a delivery technology called Paradoxical OverDose Resistance Activating System (PODRAS) that reduces the amount of drug active over 24 hours if more tablets than prescribed are swallowed. If a person deliberately or accidentally consumes more than the recommended dose, this system is designed to prevent an overdose.



The firm believes it can leverage its drug delivery and formulation competencies to help reduce the risk of abuse plaguing the drug industry. Intellipharmaceutics should also be able to develop other compounds with its PODRAS platform and help reduce overdose rates, which would represent a massive game-changer in the prescription drug market and drive quick adoption.

Bret Jensen's Small Cap Gems

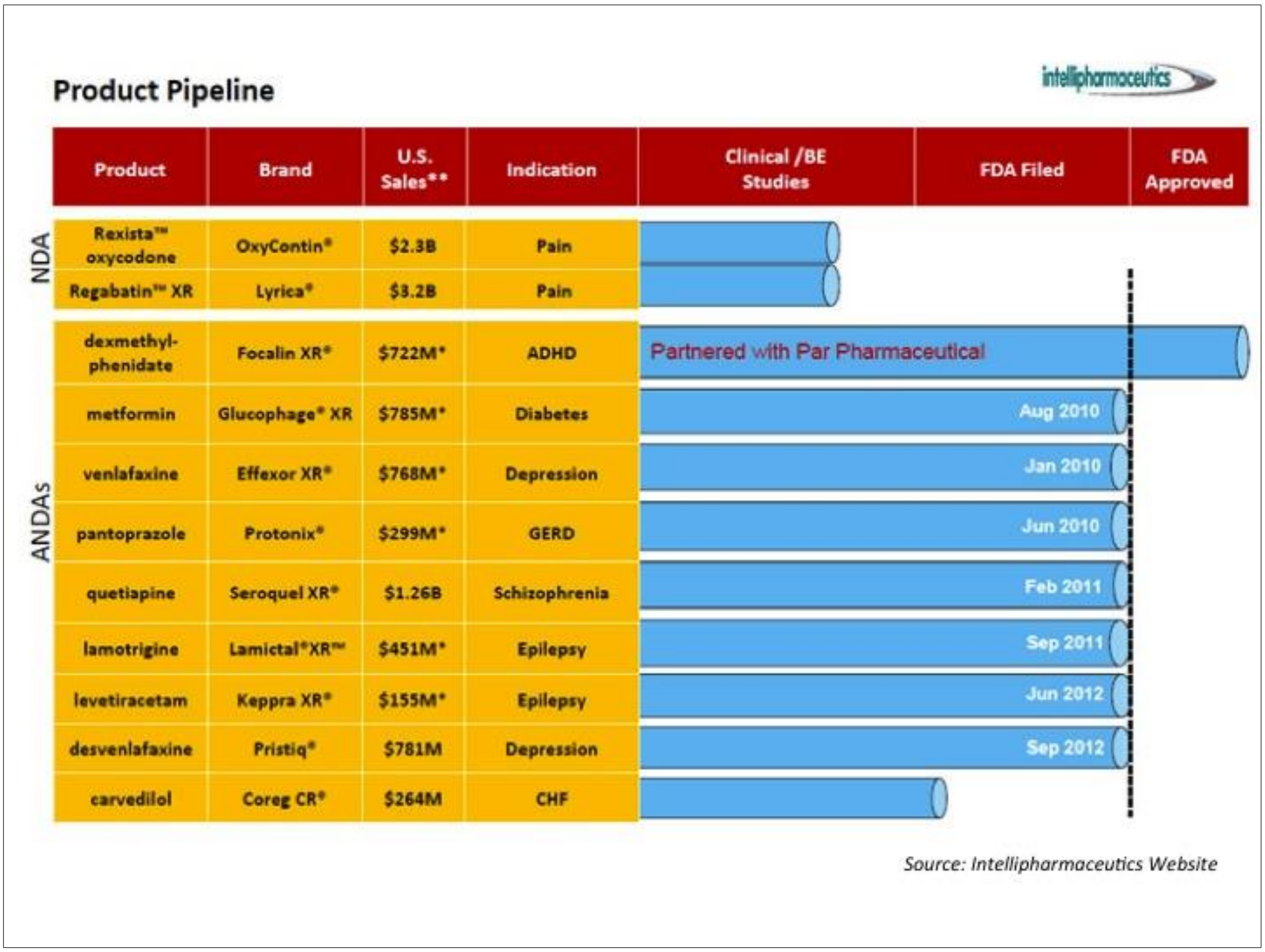
The company filed an Investigational New Drug Application (IND) with the FDA during March in anticipation of the commencement of Phase III trials. A recent notification from the FDA, however, indicated that Intellipharmaceutics would not be required to conduct Phase III studies if bioequivalence to Oxycontin is demonstrated. The firm believed that its Phase I trials comparing Rexista with Oxycontin demonstrated bioequivalence, and the FDA just granted the product Fast Track status which should accelerate the approval timeline.

The Abuse-resistant Opioid Market:

According to the National Institute on Drug Abuse, over two million people in the U.S. suffer from substance use disorders related to prescription opioid pain relievers. Overdose deaths have more than quadrupled in the past 15 years, exceeding those from all illegal drugs. In 2013, 207 million prescriptions were written for these types of pain medications.

The FDA has expressed a desire to tackle this epidemic head on, requiring an Opioids Risk Evaluation and Mitigation Strategy (REMS) for the industry in 2011 and issuing evaluation and labeling guidance for “Abuse-Deterrent Opioids” in 2013. OxyContin had estimated U.S. sales of just over $2 billion for the 12 months ending October 2014.

The rampant abuse of prescription painkillers and the FDA’s desire to curb the issue carve out a large potential market for Rexista. The impressive sales generated by OxyContin provide some guidance as to what type of



Product Pipeline

intellipharmaceutics

	Product	Brand	U.S. Sales**	Indication	Clinical /BE Studies	FDA Filed	FDA Approved
NDA	Rexista™ oxycodone	OxyContin®	$2.3B	Pain			
NDA	Regabatin™ XR	Lyrica®	$3.2B	Pain			
ANDAs	dexmethyl-phenidate	Focalin XR®	$722M*	ADHD	Partnered with Par Pharmaceutical		
ANDAs	metformin	Glucophage® XR	$785M*	Diabetes		Aug 2010	
ANDAs	venlafaxine	Effexor XR®	$768M*	Depression		Jan 2010	
ANDAs	pantoprazole	Protonix®	$299M*	GERD		Jun 2010	
ANDAs	quetiapine	Seroquel XR®	$1.26B	Schizophrenia		Feb 2011	
ANDAs	lamotrigine	Lamictal®XR™	$451M*	Epilepsy		Sep 2011	
ANDAs	levetiracetam	Keppra XR®	$155M*	Epilepsy		Jun 2012	
ANDAs	desvenlafaxine	Pristiq®	$781M	Depression		Sep 2012	
ANDAs	carvedilol	Coreg CR®	$264M	CHF			

Source: Intellipharmaceutics Website

numbers Intellipharmaceutics' candidate could do if it eventually gets approved. I have little doubt that doctors everywhere would rather subscribe an effective painkiller with abuse-resistant qualities over traditional formulations ripe for abuse.

Pipeline Products:

The company's second most advanced product in its pipeline is called Regabatin XR, targeted at management of neuropathic pain associated with diabetic peripheral neuropathy, spinal cord injury and fibromyalgia. As an extended-release formulation of pregabalin, the candidate should reduce the number of doses patients take and improve patient compliance.

Six Phase I clinical trials showed that Regabatin XR once-a-day was comparable in bioavailability to Lyrica pregabalin twice-a-day dosage and had a higher exposure during the first 12 hours. Intellipharmaceutics is in discussion with the FDA to have an IND submitted for possible commercialization following the December 30, 2018 expiration of the patent covering the pregabalin molecule. Given the patent implications, I will watch this candidate over the long term and look for FDA notifications and future clinical trials for indications of progress.

Intellipharmaceutics' pipeline is full of Abbreviated New Drug Applications (ANDAs) awaiting developments from the FDA. These drugs are generic and target patented, branded multiple dose per day products. All of the candidates are available for mid to late stage licensing and can extend the life of, improve upon or replace existing branded drugs. If any candidates receive partnership interest from the branded equivalent parent company then Intellipharmaceutics will receive significant revenue streams.

Analyst Support and Financial Position:

The company is not yet turning a profit, having recorded a net loss in the first quarter of just under one million dollars. Revenue from its agreement with Par Pharmaceuticals for the sale Focalin XR, which targets ADHD, fell primarily due to the loss of exclusivity on the 15mg capsules. The firm ended the first quarter of 2015 with slightly over $4 million in cash, the same amount it ended the previous quarter with, indicating solid management and slow cash burn.

In February IntellipharmaCeutics announced that it entered into an agreement with **Teva Pharmaceuticals (NASDAQ: TEVA)** the largest generic drug maker in the world. The agreement grants Teva the exclusive license to market an extended release drug product candidate for which IntellipharmaCeutics has an ANDA pending FDA approval. Neither firm has released specifics regarding which generic drug candidate the contract pertains to, nor have they stated any figures in regards to milestones or royalties. If the FDA approves the drug, however, I expect the company's share price will appreciate significantly and the new revenue stream should be enough to at least break even if not produce a profit.

The three analysts covering IntellipharmaCeutics have placed an average price target of $9.00 a share on the equity; impressive given the stock sells for just over $3.00 a share currently. Brean Capital reiterated its Buy rating on the firm last month, and shares of the company has rallied recently on positive news from the FDA regarding Rexista.

I like the number of shots on goal the firm's pipeline presents, and the fact that it has already progressed its Focalin product to FDA approval shows that it can find success through its development platform. Estimates expect revenue to improve from about $6 million this year up to near $15 million in 2016. If the company can bring in one more revenue stream than it currently does, which seems more than likely at this point, I'm confident it can begin turning a profit.

I will look for further developments regarding the potential blockbuster abuse-resistant candidate Rexista to be the main catalysts for share price appreciation going forward. The deal with Teva and the progression of Regatin XR, however, are two factors being overlooked by many investors right now. If the PODRAS system can successfully nullify overdose threats in other compounds then I think the firm has locked in on an industry shifting technology. If that happens IntellipharmaCeutics could well find itself a buyout target given its small size, developing pipeline and key technology.

Recommendation: Buy IPCI up to $3.75 a share with a preliminary price target of $6.00 a share.

Position: Long IPCI

Portfolio Update

The Small Cap Gems portfolio had its hits and misses in May. Our retail plays for the most part have not worked out the way I would have liked so far. Part of this is due to the contraction of the economy in the first quarter. However, growth should pick up in the second quarter and most forecasts call for the economy to accelerate further in the second half of 2015. The bigger mystery is why so little of the gasoline "tax cut" is flowing to an increase in discretionary spending outside of boosting restaurant sales. Hopefully as consumers become more confident that lower energy prices are here to stay and the job market remains strong both consumer sentiment and spending improve as we head into summer.

Our housing and construction stocks have also been slightly disappointing. April housing starts just came in at a seasonally adjusted annualized rate of 1.14 million and were up 20% from March, and this was the strongest pace since the housing collapse began to pick up pace about eight years ago. This is encouraging. Housing has run at about 1.5 million housing starts annually on average over the past few decades so even at April's levels, we still have a good way to go before getting back to "normalized" levels. We will be watching closely to see if the housing market continues to recover which will buoy our constructions plays and **LGI Homes (NASDAQ: LGIH)** had a nice move this month which may be the start of that recovery.

Our biotech positions continue to be the stars of the portfolio with the exception so far of **Conatus Pharmaceuticals (NASDAQ: CNAT)**. Both **Agenus (NASDAQ: AGEN)** and **Eagle Pharmaceuticals (EGRX)** continue to make monster moves and Eagle is now up over 400% since being included in the portfolio in December. Subscribers should be culling profits according to the oft repeated Jensen Rules and be riding on the house's money on these plays now.

This month we've added a small manufacturer whose products are showing up in more and more households, including mine. And we've gone back to the well that has nourished our little portfolio so much over the past months by adding another small promising biopharma to the mix.

Since we are already are at our optimal twenty stock level in our portfolio we are saying goodbye to two of our current selections. **Out go Big Five Sporting Goods (NASDAQ: BGFV)** and **RCI Hospitality Holdings (NASDAQ: RICK)**. Big Five has provided returns of almost 30% including dividends since being one of our first portfolio picks. However, the stock looks close to fairly valued and is close to our original price target. RCI Hospitality provided a lower percentage gain but closes out a slight winner since inclusion. The company has not progressed on moving its properties into a REIT structure which was one of the original reasons for owning the stock. It also had to settle litigation at one of its clubs in New York and lawyers may try same tactic at the company's other clubs which is headache I don't want to deal with given better opportunities available in the small cap arena.

Effective this issue BGFV and RICK will no longer be a part of the portfolio or followed by me.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Target Price	Returns	Russell 2000 Comp. Rtn.
iRobot (IRBT)	06/02/15	$32.59	$32.59	$34.00	$40.00	N/A	N/A
IntellipharmaCeutics International (IPCI)	06/02/15	$3.46	$3.46	$3.75	$6.00	N/A	N/A
New York & Company (NWY)	04/29/15	$2.76	$2.48	$3.00		-0.4%	1.9%
Ladenberg Thalman Financial (LTS)	04/29/15	$3.46	$3.28	$3.35		-2.1%	1.9%
Endocyte (ECYT)	03/31/15	$6.26	$6.13	$7.00		-2.1%	0.0%
LGI Homes (LGIH)	03/31/15	$16.66	$18.59	$18.00	$30.00	11.6%	0.0%
Great Lakes Dredge & Dock (GLDD)	02/27/15	$6.10	$5.61	$6.75	$9.00	-8.0%	1.5%
Threshold (THLD)	02/27/15	$4.37	$3.77	$5.00	N/A	-13.7%	1.5%
Mastec (MTZ)	01/30/15	$18.52	$18.17	$21.00	$30.00	-1.9%	7.4%
Eagle Pharmaceuticals (EGRX)	12/30/14	$14.20	$72.60	$15.00	$30.00	411.3%	3.2%
OncoGenex Pharmaceuticals (OGXI)	12/30/14	$2.23	$2.24	$2.50	$5.00	0.4%	3.2%
Summer Infant (SUMR)	12/30/14	$3.33	$2.36	$3.50	$5.00	-29.1%	3.2%
Agenus Inc. (AGEN)	11/28/14	$2.96	$7.95	$3.50	$9.00	168.6%	6.7%
Progenics Pharmaceuticals (PGNX)	10/30/14	$4.86	$5.55	$6.00	$14.00	14.2%	8.3%
Conatus Pharmaceuticals (CNAT)	10/30/14	$7.55	$5.49	$8.50	$15.00	-27.3%	8.3%
Abraxas Petroleum (AXAS)	09/30/14	$5.28	$3.05	$6.00	$10.00	-42.2%	13.6%
Tutor Perini (TPC)	09/30/14	$24.60	$21.19	$30.00	$44.00	-13.9%	13.6%
Beazer Homes USA (BZH)	08/29/14	$18.85	$18.24	$20.00	$40.00	-3.2%	6.6%
UCP (UCP)	07/30/14	$13.00	$7.80	$14.00	$20.00	-40.0%	9.2%
Walter Investment Mgmt. (WAC)	07/18/14	$27.27	$18.07	$35.00	$60.00	-33.7%	8.7%

Closed Positions

Company	Entry Date	Entry Price	Close Price	Close Date	Return
RCI Hospitality Holdings (RICK)	07/18/14	$11.23	$12.18	05/29/15	8.5%
Big 5 Sporting Goods (BGFV)	07/18/14	$11.51	$14.53	05/29/15	26.2%
Sonus Networks (SONS)*	08/29/14	$18.85	$7.88	03/31/15	-58.2%
American Eagle Energy (AMZG)	07/30/14	$6.36	$0.18	03/31/15	-96.7%
Avanir Pharmaceuticals (AVNR)	07/18/14	$5.39	$16.96	12/05/14	214.7%

Notes:

Entry price is determined by the last "Close" price at the closing of the market on the day before publication. Recent price is determined by the last "Close" price at the closing of the market on the day before publication; most recent update: 06/02/15. Returns is share price appreciation or depreciation between entry price and recent price. Russell 2000 Comp. Rtn. represents the returns on the Russell 2000 Index from the point of entry of a stock listed above through the recent price and is meant to provide a comparison to the overall small cap stock market as comprises that index.

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

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