Ten Year Anniversary!

Dave Peltier’s
TEN
under
$10
Stocks Under $10 turned 10 years old on May 24. Looking back on the last decade, the most desirable aspects of trading single-digit stocks are that they tend to be more volatile and less actively-followed than the “blue chips” that comprise the S&P 500 and Dow Jones Industrial Average.

To find the next potential low-dollar winners, I read everything I can get my hands on. This doesn’t just include the financial press, because I believe the best investors over the long run are the most informed.

In general, I’ll start with a thesis. For example, I’ll find a sector that I believe is performing relatively better, or could benefit from a change in the macroeconomic environment.

From there, I like to run screens. Most brokerage platforms and financial portals (Google, TheStreet, Yahoo) offer free tools that let you find the stocks with the financial characteristics you want.

From this, I can get a list of 50 to 60 potential names that I want to own. Over the years, I’ve devised an “acid test” that allows me to work down the list to 10 to 20 names.

First, I believe that investors always reward stocks with consistent, visible growth potential. Whether we’re talking sales, margins, earnings or even dividends, I look for improving trends.

Valuation is important, but you also need catalysts. A cheap stock can remain inexpensive without potential good news on the horizon.

Of every 10-20 names that make it this far, I may only find one or two (sometimes zero) stocks I want to buy at a given moment. If you can’t find a name that meets enough of your criteria, don’t hesitate until you find one that does. Reaching for a less-than-ideal investment has rarely paid off for me.

Other potential positives I look for include market share gains and increased institutional interest. In general, I try to find out whatever I can about a company before I ultimately make the decision to buy. We don’t always make the right decision when we buy a stock, but we should not often be surprised when a negative outcome occurs.

Also explore areas you might not normally check. For me, that includes price charts and chat message boards. Be patient, this process can take hours (which is the kind of work that is filtered into our newsletter).
When we do buy stocks for the model portfolio, they generally fall into three categories:

**Game Breakers**

The first are Game Breakers, which are the Holy Grail of low-dollar stocks. Here, we’re looking for companies with a new technology or business model that can be a future Google (GOOG) or Microsoft (MSFT).

These are companies with the highest risk, but also the highest potential reward. Finding these names in the early stages of the game can lead to gains of 10x or more.

With Game Breakers, the “story” can be just as important as the underlying financial metrics. Investors need to buy into the potential future or for the stock to eventually go “viral” with investors.

One current example of this in the model portfolio is Depomed (DEPO). The stock has already gained 8% year to date and 115% over the past 12 months, to about $11.41. That said, we believe the company has the potential to continue moving higher.

The healthcare firm has created a drug-delivery system, Acuform. In addition to using this extended-release technology with its own products, Depomed has licensed Acuform to other companies looking to improve existing drugs.

The company has already partnered with Merck (MRK) and Covidien (COV). Depomed also monetized its diabetes drugs last year, raising over $200 million of cash. This has provided management with deep pockets to acquire other potential blockbuster treatments.

**Point Names**

The next group of stocks we favor in the model portfolio are Inflection Point Names. We believe that contrarian investors can make the most money buying a stock when it’s temporarily out of favor. The market generally discounts news three to six months ahead. Buying ahead of the potential turnaround can yield big returns.

McDermott (MDR) and Atmel (ATML) are two current names in the model portfolio that exhibit these characteristics. Both names are familiar to a majority of investors, but had fallen under hard times in recent quarters.

First is Atmel, which makes microcontrollers for various types of electronics. When we bought it, the stock had fallen more than 10% from recent highs, but was on the verge of launching new products that would help expand gross margins.

The company also has a pristine balance sheet and is buying back stock. With profits set to more than double between 2013 and 2015 the stock appears to be a bargain at 12x expected full-year earnings, currently changing hands around $7.99.
As for McDermott, a change in management is what sparked the interest. The stock had fallen 30% in the first 11 months of 2013, before we initiated a position in engineering and construction firm for energy customers.

David Dickson had come to McDermott a couple of months previously and transitioned to the chief executive position before the end of the year. Dickson was highly regarded in the industry and had a focus on cutting costs that had mounted under the previous leadership.

As with any potential turnaround, there are usually some bumps in the road. Management is focused on execution, but bidding on fewer total contracts, in an attempt to improve overall profitability. We believe the stock, which is recently changing hands around $7.16, can move up toward the double digits in the coming quarters.

Stealth Stocks

Our final category of investments are Stealth Stocks — we believe it’s the real bread-and-butter of what we do at Stocks Under $10. This is because a lot of “real companies” generate steady growth, but fly under the radar of most investors because of their size. As a result, these names tend to trade at a discount to larger competitors. By rolling up our sleeves and discovering these stocks early, we can prosper when other investors take notice.

Callidus Software (CALD) is one such name that falls under this category. At $10.34, the stock is down nearly 30% from where we sold it earlier this year. That said, the company has gained 87% over the past year and has attractive upside potential from current levels.

We view Callidus as a miniature Salesforce.com (CRM), which is the company that put cloud computing on the map and has been one of the best performers in the overall market since 2000. Callidus has its own technological advantages, but operates in a similar business.

We believe the company can win in two ways. First, by continuing to grow and earning a higher valuation multiple. In addition, Callidus could ultimately sell to a larger company looking for its own cloud-based Salesforce management solution.

Those are four names we already follow in the model portfolio and here’s our take on six other popular low-dollar stocks:

1. Advanced Micro (AMD) has gained 4% year-to-date, but lost 4% over the past year and recently changed hands around $4.02. The company is a chip-maker that lives in the shadow of Intel (INTC:Nasdaq).

   AMD recently posted better-than-expected first-quarter results, as sales grew 28% from the previous year. Higher graphics and visual demand is offsetting a decline in computing solutions.
This marks the sixth straight quarter the company has exceeded the consensus analyst profit estimate. More importantly, AMD is expected to earn a profit in 2014, following two straight years of annual losses.

More than 18% of the trading float is being shorted and we believe the stock could see $5 over the coming quarters if management continues to exceed earnings expectations.

2. **Groupon (GRPN)** has lost 48% year to date and 13% over the past year and recently changed hands around $6.20. The popular “deals” site has struggled from increasing competition. Management guided to slower growth last quarter as customers have been slow to react to Groupon’s transition from a “push” to “pull” strategy.

Since its IPO in 2011, the company’s best asset remains its debt-free balance sheet, with $1.50 a share of cash. Despite this, the stock appears fully valued at 43x expected full-year earnings and we see limited upside potential.

3. **JC Penney (JCP)** has gained fractionally year to date fallen 49% over the past year and recently changed hands around $9.28. The Bill Ackman/Ron Johnson experiment is over but the retailer is continuing to struggle to win back shoppers and investors.

Old/new CEO Mike Ullman has cut costs, but the company is still not expected to be profitable any time soon. We believe that JC Penney will need to show sustained sales momentum for the shares to move back above $10, but this move could be accelerated by a 32% short position.

4. **Rite Aid (RAD)** moved more than 55% higher year to date, 208% over the past year and recently changed hands around $7.86. The retailer has been a successful retail turnaround that keeps rewarding investors. A store re-design has boosted traffic and the entire industry has benefited from Obamacare and the continued shift toward generic drugs.

Can the stock move even higher? Valuation must be a concern as the company is already trading at 20x expected fiscal 2015 (ending February) earnings. That said, we believe the market always rewards visible and consistent earnings growth.

5. **Sirius XM (SIRI)** has lost 7% year to date. 5% over the past year and recently changed hands around $3.24. Competition has become an issue for the company, as streaming music services continue to take hold. Even so, Sirius has delivered consistent, double-digit sales growth in the past several quarters.

Similar to Rite Aid, the company is a former turnaround story where the top question for investors going forward is valuation. If management can continue to deliver consistent growth, the next major catalyst for the shares could be a potential share buyback plan.

6. **Sprint (S)** has fallen 16% year to date, risen 63% over the past year and recently changed hands around $9.04. A consistent theme with the stocks on this list is competition. In this company’s
case, it's trying to compete with industry leaders AT&T (T) and Verizon (VZ) on price. A rumored merger with T-Mobile US (TMUS) would also increase Sprint's scale.

Even so, we believe the stock is already pricing in a lot of potential good news that may never materialize. Similar to JC Penney, what ultimately keeps us away from Sprint is the lack of clear-cut path to profitability.

Dave Peltier only buys Stocks Under $10 that he thinks could potentially double or triple in the next 6 to 12-months.

See what he's trading today with a 14-day FREE pass.