A Decade of Institutional Quality Research on Undiscovered Microcap Stocks

At GeoInvesting, our mission is to provide institutional quality research for the everyday investor normally reserved for clients of prominent Wall Street investment banks. For the last eleven years, our company has made a name for itself as a leader in finding extremely undervalued U.S. microcap equities and warning investors of public companies misrepresenting their stories to the market. Our co-founder, Maj Soueidan, has been a successful full-time investor for nearly three decades.

Our work in exposing more than $10 billion in U.S. listed China based frauds was featured in the recent documentary *The China Hustle*. We specialize in identifying companies that are at growth inflection points and companies that have been unnoticed or under-noticed by the market and traditional Wall Street analysts.

We have an in-house team of analysts that are cross disciplinary in nature – all of whom are seasoned professionals and have an “outside the box” methodology which allows us to often “one-up” the research that comes directly from Wall Street.

Please enjoy this special report on why **we love recurring revenue business models**, such as medical devices and Software as a Service (SaaS) companies, exclusive to our premium members.

Special Report: Gain Confidence by Investing in Recurring Revenue Stocks

Investors like certainty.

Companies where sales and profits are predictable, compared to being lumpy and uncertain, tend to see their stocks trade at premium valuations. And although it can take time, when these types of business models reach inflection points of growth, their share prices can appreciate quickly. One of the best areas to look for these opportunities in the stock market is in software companies that build "sticky" business models where customers keep paying fees to use the software and maintenance services, month after month, year after year.

Shortly after the turn in the millennium, software companies slowly started to figure this out. Traditionally, software companies would sell their software platforms in a fashion where customers would pay a (sometimes massive) one-time, up front licensing fee and then maybe a lower monthly or annual maintenance fee. This arrangement is sometimes referred to as a perpetual license. Furthermore, the software and all the related hardware and server equipment would be installed and located at the company. If you have heard the phrase "on premise", it is referring to this type of situation where everything is "hosted" at a company's location. When software companies sell a perpetual license, they get a big pay day. However, this "old school" model has three general shortcomings.

First, the large upfront licensing fee limits the size of customers that a software company can target. Smaller and medium size enterprise (SMEs) may not be able to afford big price tags. In fact, in the U.S., "30 million SME accounted for two thirds of net new private sector jobs over the past few decades" and make up 99% of all companies in the European Union (EU).

Second, a company must shell out capital to "wire" and fit their facilities with equipment such as servers, needs that will grow as a company grows.

Third, quarterly and annual financial results can be very lumpy, creating uncertainty and volatility in the stock, which could lead to depressed valuation metrics.

In order to understand where some of our stocks are heading, I thought it would be a good idea to discuss the characteristics of three common software revenue models and have included an appendix at the end of this report to show how they are applied in real life:

- Perpetual License

- Subscription
- Software as a Service (SaaS)

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By contrast, in some recurring revenue software models, the customer pays smaller on-going fees for the right to use the software for a period. Even though revenue per customer in this type of relationship is typically less in the short term, compared to a perpetual license, over time a customer could end up generating more revenue. These models also give companies a smoother quarterly revenue profile which appeases investors' risk aversions. These types of models also open the door to more potential customers because the large upfront perpetual licensing fee limits the size of customers that a software company can target.

Enter SaaS

This is where Software as a Service ("SaaS") comes in. SaaS is "a software distribution model in which a third-party provider hosts applications and servers, and makes them available to customers over the Internet. SaaS is one of three main categories of cloud computing."

SaaS offerings can usually be paid for on a per use, monthly basis or annual basis.

SaaS companies traditionally have higher margins than other businesses because they are easier to scale. Because the software is actually the service, the amount of personnel necessary in order to scale up operations (either for one client or for multiple clients) is minimal. This keeps the cost burden on the SaaS company low and allows for significantly more operating leverage than one would see in most traditional businesses.

This Martinwolf report notes the differences between Tier 1 and Tier 2 SaaS players, implying that Tier 1 companies are deserving of premium multiples. Martinwolf goes on to say that Tier 1 SaaS companies grow revenues at an average of 27% and those that are profitable will command higher valuations.

> "In simple terms, the companies that can grow the fastest and most profitably will earn higher valuations."

According to the report, Tier 1 SaaS companies can be valued at a price to sales multiple of as high as 7.5x.

SaaS and Recurring Revenue Transformations Present "Valuation Gap" Opportunities

Our attraction to recurring revenue builds on our obsession to find stocks with mispriced recurring revenue business models. Long-time GeoInvesting members know that one of our favorite places to look for these types of chances is in companies that are transitioning their businesses from lumpy revenue streams to predictable and growing ones. Software companies shifting from perpetual licensing models to SaaS models are a great place to find these gems.

SaaS, or recurring revenue "transition companies", will often experience large discounts to valuations compared to peers that are mainly generating recurring revenue. This gives us a chance to buy shares of well-managed companies at attractive valuations. This valuation gap generally exists for two reasons.

First, until the business model shift is complete, revenue streams, quarter to quarter, can still exhibit a good deal of lumpiness. It will take time (maybe multiple years) for revenue growth to look cosmetically appealing on a quarterly year over year basis (for example Q2 2018 vs Q2 2017). This is because perpetual licensing revenue is generally larger than then smaller SaaS streams and investors often can't see what lies beyond the surface.

Second, there is no guarantee that management will successfully execute a transition.

Some key transition trends to monitor are the change in the percent of recurring revenue as a percent of total revenue and the recurring revenue growth on a sequential basis (for example Q3 2018 vs Q2 2018). Eventually, year over year comps will present themselves favorably on an "apples to apples" basis. This is when valuation multiples can start to experience a significant and rapid expansion.

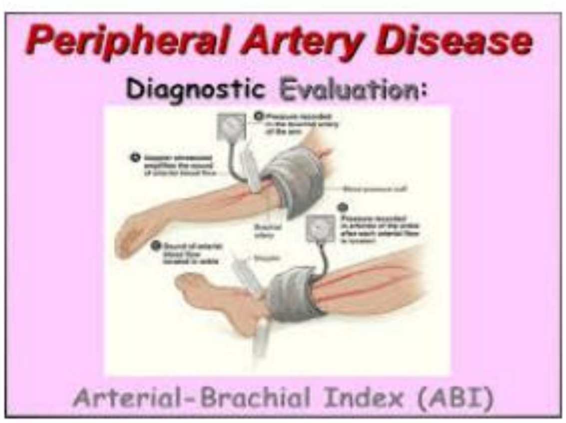
Medical Device Stocks

SaaS companies are not the only types of businesses that can have recurring revenue type characteristics. Medical device companies, where the device has a disposable feature, can generate a good deal of recurring revenue. For example, devices that administer routine tests to monitor patient's vitals who have gone through surgeries or are at a high risk for certain medical conditions often create recurring streams of revenue. One good example is Semler Scientific (OOTC:SMLR).

SMLR was introduced to GeoInvesting through one of our Premium Members at around $2.00 and has since increased over 1000%.

SMLR currently derives most of its revenue from selling its Quantaflo product to healthcare practitioners to aid in the diagnosis of Vascular Diseases for high risk patients.

The company generates revenues from monthly software license fees and/or a per test fee. Management claims that its Quantaflo product, launched in 2011, is a more convenient and effective way to monitor blood flow obstructions to aid in the diagnosis of Vascular Disease than competing products.



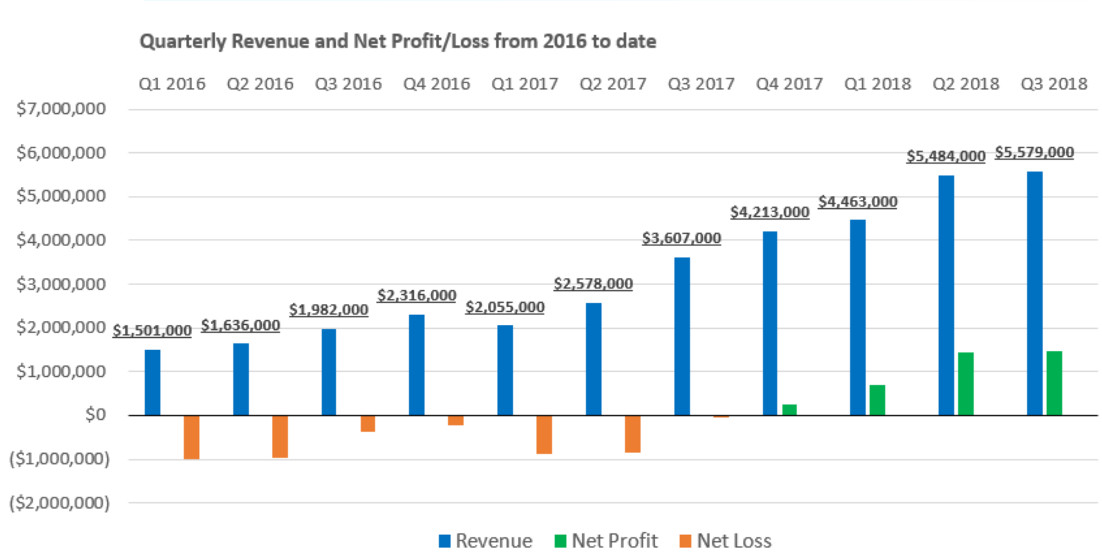
The company was losing money at the time our premium member wrote it up and it had not yet shown a significant growth in sales. Unfortunately, no one on our team bought the stock.

By April 2018, the stock was trading in the $8.00 area when I received a phone call from an investor in our professional network. He asked me if I knew of SMLR and suggested that I should take a serious look at it and interview management, even though the stock had increased sharply. I did just that, and then wrote a report on the company, disclosing that we had bought the stock.

The stock recently reached $40.00 after reporting its second quarter 2018 sales and earnings. Sales increased 113% to $5.4 million and earnings per share rose to $0.19, compared to a loss in the second quarter of 2017. This marked the third consecutive quarter of profitability for the company and shows how a business built around a recurring revenue theme can eventually reach profitability and accelerate the pace at which it grows earnings. The company just reported strong Q3 2018 results but has recently pulled back to around $31.00 amid market volatility.

We compiled a chart of SMLR's financial performance to show the "hockey stick" type earnings growth that recurring revenue models can achieve as business expands.

Performance



Notice how fast EPS accelerates once a certain revenue point is reached. The moment at which a recurring revenue model achieves profitability is an important inflection point and can be thought of as a fly wheel.

The Fly Wheel

In his book, “Good To Great”, Jim Collins talks about companies reaching an inflection point by comparing them to a fly wheel, where momentum gains traction, allowing companies to break through walls to ramp up growth:

> “Picture a huge, heavy flywheel—a massive metal disk mounted horizontally on an axle, about 30 feet in diameter, 2 feet thick, and weighing about 5,000 pounds. Now imagine that your task is to get the flywheel rotating on the axle as fast and long as possible. Pushing with great effort, you get the flywheel to inch forward, moving almost imperceptibly at first. You keep pushing and, after two or three hours of persistent effort, you get the flywheel to complete one entire turn. You keep pushing, and the flywheel begins to move a bit faster, and with continued great effort, you move it around a second rotation. You keep pushing in a consistent direction. Three turns ... four ... five ... six ... the flywheel builds up speed ... seven ... eight ... you keep pushing ... nine ... ten ... it builds momentum ... eleven ... twelve ... moving faster with each turn ... twenty ... thirty ... fifty ... a hundred.
>
> Then, at some point—breakthrough! The momentum of the thing kicks in in your favor, hurling the flywheel forward, turn after turn ... whoosh! ... its own heavy weight working for you. You’re pushing no harder than during the first rotation, but the flywheel goes faster and faster. Each turn of the flywheel builds upon work done earlier, compounding your investment of effort. A thousand times faster, then ten thousand, then a hundred thousand. The huge heavy disk flies forward, with almost unstoppable momentum.”

Although some of the best upside opportunities exist by taking early bets, well before the flywheel gets moving, these can also be the riskiest bets, since the model may not have been proven to work yet, or ineffective management may be leading the ship. That is why I like to pepper my portfolio with stocks that are just about to reach inflection points, where I feel the upside is still high, but is accompanied by less risk of failure.

In 2014, we did this by investing in SaaS companies that help customers with their e-mail marketing and lead generation goals. Many of these stocks were experiencing an acceleration in their growth. At the time, we noticed a trend where larger firms like $ORCL and $IBM were buying these types of companies at large premiums, sometimes as high as 8x revenue.

We bought and wrote about 5 of these companies that were selling at price to sales multiples under 4x, that we believed were acquisition targets. 4 of the 5 were acquired (within 6 months to 1.5 years from publication of our initial research to GeoInvesting Premium Members). Overall, the average return of these SaaS plays ended up being around 32%. Had we known more about the SaaS space like we do now, we feel we could have done a better job avoiding some of the subpar performing stocks in the group.

Avoided Disaster

I have to admit, we got a little lucky. We placed our bets, but the SaaS trade was still new to us, and we didn't necessarily understand all we needed to know about the space. In fact, I was writing a short thesis report on an email marketing SaaS company at the time. The company was growing revenue but losing money.

It wasn't until several pages into the report, when I was about to publish the article, that I started doubting my original intuition. I took a step back and started interviewing SaaS management teams and investors who knew the space well. It became important to understand that just because a SaaS company is losing money, doesn't mean it's a bad investment candidate.

At some point, high recurring revenues, with high gross margins, combined with high customer retention rates and a reasonable pace of new customer additions can lead to revenue being able to easily cover marketing and customer support expenses. This is a very important point. The reason you see many recurring revenue models lose money early in their growth cycle is because management knows how crucial it is to get to a customer level where profits will begin to explode.

After this extra due diligence and observing the hot acquisition activity in the space, I ditched the short-selling project. Several weeks later the stock got acquired at 5.7x revenue and 62% above where I would have shorted it.

I decided to stop looking at SaaS companies the way I looked at other types of stocks, especially after noticing the trend of SaaS acquisitions at high multiples. We started alerting our Premium Members of SaaS companies we began buying that we thought were great acquisition targets. The move paid off when several of these stocks were quickly acquired at large premiums to where we went long.

Recurring Revenue Is Now a Core Part of GeoInvesting's Strategy

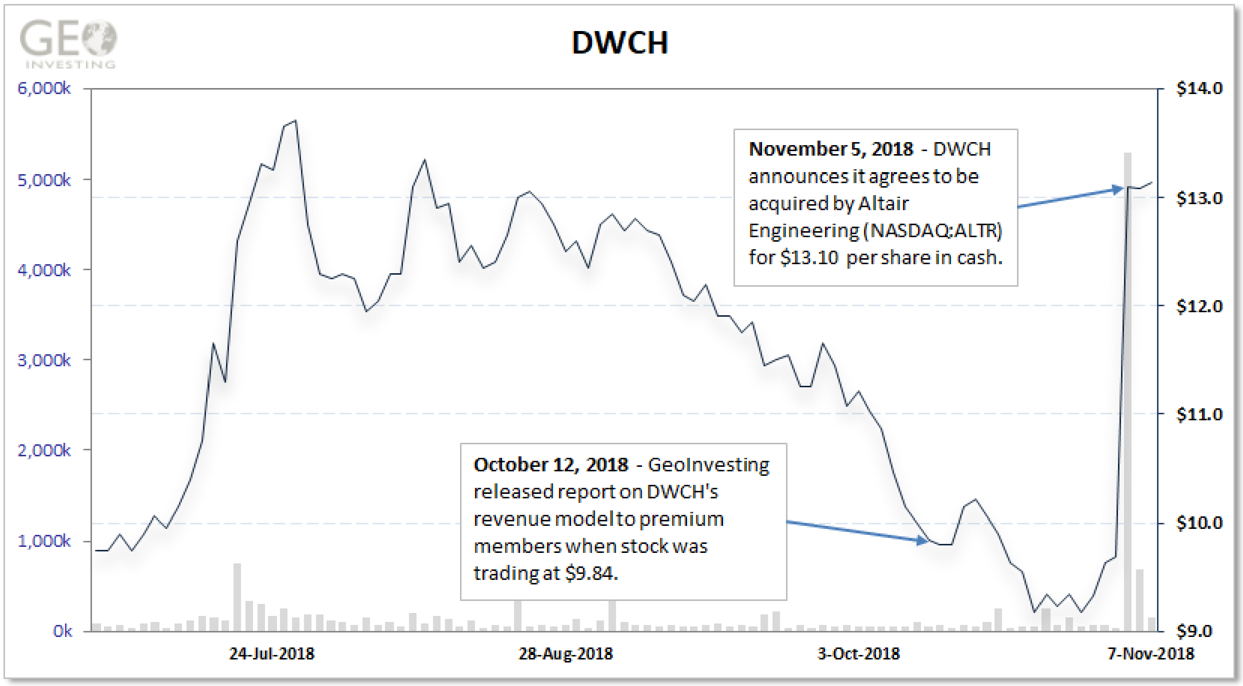
The eventual success we had investing in SaaS firms set us on a path to try to find recurring revenue model type companies well before their growth inflection points are reached, so we can buy shares at extremely low valuations. In fact, I am contemplating devoting most of my capital to SaaS like stocks. These days, we look for SaaS type models, not just in software, but wherever we can find them.

Medical device companies that test for diseases, deliver medication and monitor health conditions tend to also be places where we are finding these opportunities. Currently, we have research on 6 companies that have recurring revenue/sticky customer models selling at price to sales multiples well under industry averages and their competitors.

Of these six companies:

- One medical device company has just passed its inflection point and is experiencing a tremendous amount of insider buying.
- A medical device company with a best in class product led by a first-class CEO is getting very close to an infection point.
- One SaaS company still must prove it can deliver.
- One SaaS/Telecom at its inflection point selling at an extremely low price to sales multiple.
- One insurance management software stock just entered our radar, that is transitioning to a SaaS model.
- One SaaS company we profiled at a price of $9.84, Datawatch Corporation (NASDAQ:DWCH), was recently acquired at roughly a 30% premium to its market price.
    - Our October 12, 2018 "Reasons for Tracking" report on DWCH highlighted why we believed it was in the late innings of transitioning from a perpetual licensing business model to a recurring revenue software model. We felt this new model could eventually provide the company with a more predictable revenue stream, better growth outlook and an expansion in its valuation multiples. DWCH's acquirer, Altair Engineering, must have agreed with us. In all, our report was an example of research that embodies all the ideas and things we look for when we conduct due diligence SAAS companies.
    - While it is nice to see this, we feel the acquisition still undervalues DWCH when compared to peers. We are disappointed that management is selling the company at a valuation well below its closest competitor Alteryx, Inc. which sits at a 350% higher price/sales valuation than DWCH's takeover multiple, especially

when it appears that the company has the best in class and the most complete product offering amongst its competitors.



Bet the Jockey, Not the Horse

The medical device company (second bullet point above) that we believe is getting very close to a profit inflection point is a very interesting story that involves a CEO whose last three business ventures were acquired by bigger firms at large premiums.

The CEO came to the company to sell money losing assets and reposition it for growth by concentrating on a product that old management had ignored. The company offers a solution to hospitals to monitor a set of patient's vitals during surgery. The company sells a monitor that displays readings, but also sells disposable sensors that generates the stats. So, with each surgery, new sensors must be used (and purchased). With its best in class solution and 99% customer retention rate, the company is quickly stealing market share from its 3 main competitors. We recently published a research article on the stock after interviewing management to inform our Premium Members about our findings.

We know we may be a little early investing in this stock, but we really like the CEO and are putting our confidence in him based on his track record of success. We think a huge inflection point will occur within the next 4 months but believe that the stock will move up ahead of this transformational event and eventually rise significantly above its current price. Accepting our special offer will give you access to this member only research report along with all our premium content GeoInvesting.

Appendix

Model Outline: Perpetual vs. Subscription vs. Saas

Here is a brief comparison on how the three models look:

Pre-SaaS/subscription fee model days, commonly referred to as perpetual licenses. Typical aspects of these relationships include:

- Customer pays one-time, up front, licensing fee to own the software
    - Revenue is recognized on the books right away/
- Customer has the option to pay an annual upfront maintenance fee to receive services and updates from the Company. Fee can be renewed, annually.
    - Fee is recognized over the term of maintenance contract. The unrecognized portion of the fee is recorded as deferred revenue on the balance sheet.
- Servers and hardware are usually the responsibly of the customer, also referred to as on- premise relationship

Assume a software company inks a $100K deal with a customer on January 1, 2018:

1. On January 1, customer pays $100K for right to own the software
    a. Revenue is recognized on the books right away.
2. On January 1, customer agrees to pay 20% ($20k) of license fee as maintenance for one year. Revenue is recognized over 12 months.
    a. Company gives customer option to renew the maintenance contract at $20K per month.
3. Lifetime revenue to company equals one-time payment of $100k + $20K for as many years as contract is renewed.
    a. After 3 years, revenue received was $160K

Subscription fee model. Aspects of this type of relationships include:

- Customer pays an annual upfront fee for the right to use the software and receive maintenance services for a period of time.
    - Until recently, the entire fee was recognized over the term of the contract. The unrecognized portion of the fee is recorded as deferred revenue on the balance sheet.

- Now, due to a new GAAP accounting rule, Topic 606, a portion of the fee must be recognized right away, and a portion is recognized over the life the contract.

- Customer has option to renew the relationship, annually.
- Maintaining servers and hardware are the responsibly of the customer, also referred to as on- premise relationship
- In the short run, the annual upfront fee is typically less than the combined fees that would occur under a perpetual licensing arrangement.

Assume a Software Company inks one year $50K deal with a customer on January 1, 2018.

1. On January 1, customer pays $50K for right to use software and receive maintenance services for one year.
   a. 80% of revenue is recognized on the books right away.
   b. 20% Of revenue is deferred
   c. Company gives customer option to renew the relationship, annually.
2. Life time revenue to company equals payments for as many years as contract is in place.
   a. So, after 3years revenue received = $150

Software as a Service (SaaS) Model. Aspects of this type of relationships include:

- Customer pays an annual upfront fee for the right to use the software and receive maintenance service.
  - Until recently, the entire fee was recognized over the term of the contract. The unrecognized portion of the fee is recorded as deferred revenue on the balance sheet.
  - Now, due to a new GAAP accounting rule, Topic 606, a portion of the fee must be recognized right away and a portion is recognized over the life the contract.
- Customer has option to renew the relationship, annually.
- Unlike a perpetual license or subscription fee model, servers are hosted in the cloud and less hardware is required to be maintained by the customer.
- In the short run, the annual upfront fee is typically less than combined fees that would occur under a perpetual licensing arrangement

Assume a software company inks a one year, $50K deal, with a customer on January 1, 2018:

3. On January 1, customer pays $50K for right to use software and receive maintenance services for one year.
   a. 80% of revenue is recognized on the books right away.
   b. 20% of revenue is deferred
   c. Company gives customer option to renew the relationship, annually.

4. Lifetime revenue to company equals payments for as many years as contract is in place.
    d. After 3 years, revenue received is $150k