

In for a penny

Shrewd investors in very low-priced shares can find a bargain, while the unwary can find themselves being short-changed, says Richard Beddard

There are nearly 900 companies with shares listed at between a quarter of a penny and 20p on the Alternative Investment Market (Aim) or in the nether regions of London's main market. Companies don't usually list at prices below 20p, so they're down there for a reason, mostly because they haven't performed as well as investors expected.

Investors often regard penny share companies as a gamble, because they are so small and unpopular that it's difficult to find information about them. Newspapers rarely publish articles about penny shares and City brokers seldom cover them, so forecasts may not exist, or come only from the keyboard of the company's own friendly broker.

Hidden gems

However, this dearth of information does have advantages for private investors. Fewer people watch penny shares, which means the dogged investor can find undiscovered bargains using the financial information freely available in company annual reports and regulatory filings.

The difficulty is that, as well as hidden gems, there are also many poorly performing companies with complicated histories and unproven managers in the penny share category. Getting decent returns from penny share invest-

ing means finding companies with good businesses at attractive prices.

Picking just four shares, as we do every year, is a gamble however hard you look, and that's reflected in the fate of last year's selections. Woolworths famously went bust, and Carpathian Resources cancelled its listing in London, forcing investors to sell at around half our tip price or allow their holdings to be deported to the Australian Stock Exchange.

Previous years' selections that have also gone into administration or delisted since our last update include Appian

Technology, Entertainment Rights and Axis Intermodal.

Of this year's selections, Alkane Energy and Red24 are out of favour because they've disappointed investors in the past, while United Carpets is particularly exposed to the recession. Huveaux, a media company, is also in a depressed sector and has the dubious distinction of having suffered problems of its own making too.

All of these companies seem to be doing the right thing now, though, and if they recover, they should make us a good return.

Seven golden rules of penny share investing

- **Do your homework**

Read the annual report and the company's recent announcements. Speculating on penny shares is risky, but you can reduce the risks by checking a company's record and the strength of its finances.

- **Talk to management**

Managers of smaller companies usually answer the phone. They can't give you important information if it is not already widely known, but you can ask them to clarify and explain.

- **Tot up major shareholdings**

It's a good sign if directors have sizeable shareholdings, but if any group of shareholders owns more

than 50 per cent – or, worse, 75 per cent – they can take momentous decisions without the approval of other shareholders.

- **Avoid companies with sizeable holdings in other companies**

Smaller companies are relatively easy to understand unless they have stakes in other companies that you must evaluate.

- **Check the exchange market size**

Market makers offer firm prices up to a certain number of shares. The smaller and less popular a company, the lower the number will be. If you want more

shares you may have to pay more or buy in batches.

- **Calculate the spread**

The spread is the difference between the buying price of a share and the selling price. Small, unpopular companies often have wide spreads, so make sure there's enough profit in the trade to make it worthwhile.

- **Sell if the story changes**

Penny share prices are sometimes volatile. Try not to be influenced by price movements you can't explain, but if there is a good reason to sell or your initial judgement was wrong then sell quickly.



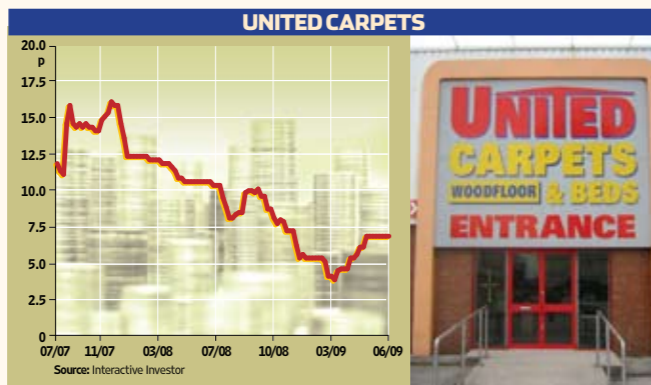
THIS YEAR'S SELECTIONS

📍 **Huveaux (HVX)**
 Market cap: £13.3 million
 Price: 8.75p
 Yield: Nil
 Price/earnings ratio: 10

In its 2008 annual report, chief executive Gerry Murray said Huveaux was 'a fundamentally different company' from the one that started the year – good news given that, at the start of 2008, it was sinking under its own buy and build strategy.

In 2001, Huveaux's founder, John de Bloq van Kuffeler, set out to buy publishing, training and events companies and build them into a business-to-business media empire. By 2008, its acquisitions spanned political and public sector publishing, training, events and recruitment, three French healthcare magazines, and revision guide publishers Letts, Lonsdale and Leckie & Leckie.

However, Huveaux paid too much for some of these businesses,



with their flat revenues and falling profits. It was building an increasingly indebted and less profitable group.

Last year Huveaux sold its healthcare business, which was struggling to attract advertisers, and Epic, a public sector training company. Its founder has left and the board has a new look to it. The new chairman, Kevin Hand, has been a non-executive

director since 2006. Finance director Rupert Levy joined in April 2008.

A company that has botched so badly is a contrarian recommendation. But although recessions are bad for advertising, Huveaux earns more revenue from its revision guides and political events, and now it is correcting its mistakes, the shares could recover.

It has been a terrible year for flooring and furniture retailers. Sofa sellers Land of Leather and SCS Upholstery went into administration, and even former stock market darlings such as Carpetright experienced plunging profits and a falling share price. With fewer houses changing hands and householders saving rather than spending, companies are investing more in marketing just to maintain sales, which means lower profits and dividends. When United Carpets announced its interim results in December, it said it wouldn't pay a dividend, although it expected to announce a final dividend when it published its results for the year to March 2009, in late July.

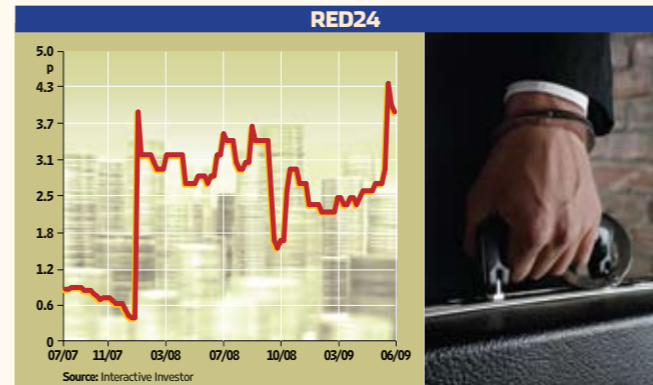
Cautious investors will wait for the results and confirmation that United Carpets has sustained the slight improvement in sales recorded in November and December, but, barring catastrophe, the shares are good value. The company caters to price-conscious consumers, which has protected it to a degree from a recession it entered as a growing, financially strong company.

📍 **United Carpets (UGC)**
 Market cap: £5.5 million
 Price: 6.75p
 Yield: 12.3 per cent
 Price/earnings ratio: 5

If you watch Granada, Yorkshire, Tyne Tees, or Central television, you may have heard of United Carpets, and not just because of its television advertising. Those are the television regions in which it operates and franchises 80 stores selling carpets, flooring and beds.

📍 **Red24 (REDT)**
 Market cap: £1.8 million
 Price: 4p
 Yield: Nil
 Price/earnings ratio: 4

The news streaming across Red24's website is grim: a train collision



in China, a bomb blast in the Philippines, ethnic clashes in Tanzania and fighting in Beirut. But it's just another day for the global security consultancy that advises individuals in danger from threats such as terrorism, natural disaster and identity theft.

Companies engage Red24 to protect and train their staff, and banks and insurance companies bundle its services with their own products.

Although Red24 listed in 2002, it's taken until 2009 for it to make a profit. Heavy investment funded by shareholders yielded repeat losses, and it was only after a change of management in 2007, more fund raising, the closure of its Japan office and the slimming down of its offices in London and Johannesburg that it began to turn itself around.

For the year to 31 March 2009, the accounts look more promising.

Red24 was profitable in cash as well as in accounting terms, and it paid off some debt.

Executive chairman Simon Richards believes its protracted development is over and Red24 has no need for more capital, although it plans to extend the remaining £250,000 it owes in loan notes until September 2010.

The principal risk may be its dependence on HSBC and AIU (formerly AIG), its biggest partners, although Richards says it's gaining new business. If it can grow profitably, tiny Red24's shares look cheap on a p/e ratio of just four.

📍 **Alkane Energy (ALK)**
 Market cap: £17.6 million
 Price: 19p
 Yield: Nil
 Price/earnings ratio: 9

Alkane Energy was a 'jam

tomorrow' company, promising profit from methane, but not delivering it until 2006. In subsequent years, it has increased profits, but investors, perhaps disappointed by years of losses, have hardly noticed.

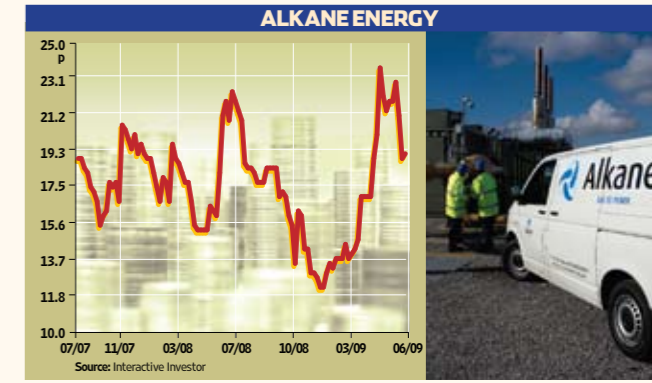
The allure of methane as a fuel, and Alkane as an investment, is that methane is a damaging greenhouse gas released from coal mines. Alkane's eight methane extraction plants – seven in the UK and one in Germany – remove the gas from old mines for electricity generation or industrial heating. Since the gas no longer seeps into the atmosphere, Alkane saves the equivalent of about 560,000 tonnes of carbon dioxide a year, or three return flights per day from Heathrow to New York.

Chairman John Lander traces Alkane's profitability back to the

decision to generate electricity from methane in 2004, and in the year ending 31 December 2008, high electricity prices helped Alkane record strong results, revealing an increasingly profitable and cash-rich company.

Alkane has fixed the electricity price in its contracts for 2009 at a higher rate than last year, so investors expect more profit. Increasing profits, coupled with no bank debt and cash and loan repayments from the sale of its stake in an associate, have given the company's new chief executive the confidence to more than double production. Construction has started on two new plants.

With its growing record of profitability and credible growth prospects, a p/e ratio of nine seems too low, even though electricity prices could fall after 2010.



LAST YEAR'S SELECTIONS

📍 **Leeds Group (LDSC)**
 Tipping price: 17.65p
 Price now: 14.5p
 52-week high/low: 18p/14p

Last year, we hoped Leeds might engineer a recovery at ailing Dawson International, an Aim-listed cashmere company. Leeds, which owns a 28.8 per cent stake, replaced Dawson's chairman with its own man and the company has now made its first profit since 2005.

Subsidiary Hemmers-Itex, a wholly owned German fabrics wholesaler, remains profitable, but costs are rising faster than revenues, and the group is having to put more effort into weathering the recession and less into growth and acquisitions. The shares are cheap, on a price/earnings (p/e) ratio of four,

but although Leeds thinks it's onto a winner with Dawson, Dawson's patchy record of profitability means there's plenty of doubt.

📍 **Advanced Power Components (APC)**
 Tipping price: 20p
 Price now: 15p
 52-week high/low: 20.5p/8.5p

APC, an electronics distributor, was growing last year, but it spooked the market in March when it revealed it would record a loss for the six months to February 2009, due to rising costs, delayed shipments and inaccurate forecasts.

The market is in a more forgiving mood now APC's finance



director has gone and the firm has hedged its exposure to the dollar and raised £400,000.

The shares look cheap. However, APC lost money for five years after the technology bust, and it is feeling the effects of the current recession.

PREVIOUS YEAR'S SELECTIONS

📍 **Media Square (MSQ)**
 Tipping price: equivalent to 115p
 Price now: 14p
 52-week high/low: 62.5p/4.5p

This advertising and marketing consultancy could be derailed by recession, even though, excluding the business units it shut down in the year to February 2008, it made a small profit.

Executive chairman Roger Parry has closed the company's unprofitable businesses and is abolishing its complex divisional structure, selling off surplus properties and shrinking the company to what he expects to be a profitable core.

Last year we were right to be ambivalent. After a one-for-10 share consolidation in July 2008, the shares fell from an equivalent price of 61p to just 4.5p in April. Parry believes in the company, though. He bought modest quantities of shares throughout the year, most recently 100,000 at 11p in June.

📍 **Eurovestech (EVT)**
 Tipping price: 18.25p
 Price now: 13.5p
 52-week high/low: 18p/10.75p

Eurovestech owns two technology companies and a stake in five more, but its jewel is Toluna, which conducts

online market research by polling consumers. In June, Toluna placed shares with a new investor and Eurovestech sold some of its stake, reducing its holding from 50.6 per cent to 29.9 per cent, earning about £7.5 million.

Toluna is growing rapidly, and Eurovestech's remaining holding is worth more than £31 million. So far, it has realised nearly £15 million from its total investment of £2 million.

Clearly, founder and chief executive Richard Bernstein has picked a winner. But in recent years the market has sometimes valued Eurovestech at little more than the value of its Toluna stake, so much now depends on the rest of Eurovestech's venture capital portfolio.



Richard Bernstein: Eurovestech founder

📍 **Nautical Petroleum (NPE)**
 Tipping price: equivalent to 154.2p
 Price now: 56p
 52-week high/low: 165p/20.75p

Last year, we said Nautical Petroleum must find oil to revive its share price. However, disappointing drilling results, a \$105 (£65.39) drop in the oil price and recession conspired to knock it down to 20p around the turn of the year.

Oil prices have recovered somewhat since then, and so has Nautical Petroleum. The company is developing licenses in the Mariner and Kraken oil fields in the North Sea and expects them to be producing heavy oil from 2011 and 2012 respectively.

Shareholders will need patience and fortitude. Although chief executive Steve Jenkins says the company has the resources (£21 million in cash) to develop its two big prospects, Nautical is unlikely to make a profit until the oil flows.

Penny shares

⊙ Dana Petroleum (DNX)

Tipping price: equivalent to 217p

Price now: 1,402p

52-week high/low: 1,853p/641.5p

We tipped shares in Dana, an oil and gas producer, back in 2001 and, due to share price consolidations and the company's growth, it's no longer a penny share.

Last year was a record one for the company, which operates in the North Sea and North Africa. It produced more oil and gas and added more reserves than ever, and turnover and profit reached record levels. But a collapse in the price of oil and the prospect of recession overshadowed its achievements, and Dana didn't join the FTSE 100 as we hoped.

It's firmly in the FTSE 250 though, with a market capitalisation of more than £1 billion, and investors who were quick when Dana hit three-year lows of between 600p and 800p at the turn of the year, picked up a bargain.

⊙ Northern Petroleum (NOP)

Tipping price: equivalent to 66.25p

Price now: 117p

52-week high/low: 145p/53p

Northern Petroleum booked a big profit this year, but it was mostly a one-off on the sale of underground gas storage interests. Chairman Richard Latham claims he could see the turmoil coming in 2006, which explains the canny sale while prices were high and, he says, good cost management.

In the Netherlands, Northern Petroleum expects to exceed its production and profitability forecasts. In Italy, it has agreed farm-out agreements with Shell to develop some of its fields. It is buying struggling ATI, a UK exploration company that shared some of Northern's Italian interests.

The company reports in euros now to protect it from exchange rate movements. And it seems to have the finance and credibility to develop its fields.

⊙ EnCore Oil (EO)

Tipping price: equivalent to 21.9p

Price now: 16p

52-week high/low: 41.5p/7.25p

This oil explorer's shares have had a rough ride this year and investors won't



A strong balance sheet is a stabilising factor: Invensys

want an encore. Unlike Northern Petroleum and Dana Petroleum, EnCore Oil doesn't produce oil. It establishes the potential of fields and then sells them or farms production out.

The big hope last year was the Esmond Gordon gas storage project, with an estimated value of up to £200 million. However, an announcement in November threw Esmond Gordon's viability into question, punctured the share price and demonstrated how risky exploration companies can be.

EnCore is still capitalised at £46 million, and much of that value comes from its 15 per cent interest in Breagh, one of the North Sea's largest undeveloped gas fields, which it plans to sell.

⊙ Scapa (SCPA)

Tipping price: 19.25p

Price now: 14.5p

52-week high/low: 29.25p/9.25p

Confidence in industrial tape manufacturer Scapa grew last year, as the company trebled its profit per share and reinstated the dividend. However, recession put paid to its profit and the dividend, as Scapa slumped to a loss in the year ending March 2009.

Scapa seems to have to work hard just to stand still. It has a long and mostly profitable record, and no debt, but new investors may hold off until it starts adding to its cash balances again. The chairman says efficiency savings mean that this should now happen, even if the 20 per cent fall in volumes persists.

⊙ Antisoma (ASM)

Tipping price: 18.75p

Price now: 24p

52-week high/low: 30.5p/17.5p

Antisoma, which specialises in developing cancer treatments, is unusual among our past tips. Its share price last year was less volatile than we predicted.

But its stint as a profitable UK biotech company ended in February, when it posted its interim results. Having received \$100 million from Novartis for the rights to its ASA404 lung can-

cer treatment and sold the US rights to oral fludarabine, a treatment for chronic lymphocytic leukaemia, in May, it's relying on its cash resources to fund the continuing development of its drug pipeline. Chief executive Glyn Edwards says the money should last until at least mid-2011.

⊙ Invensys (ISYS)

Tipping price: equivalent to 105p

Price now: 223p

52-week high/low: 296p/122p

With a market capitalisation of nearly £2 billion, Invensys is one of the 100 biggest companies on the stock market. Last year, we anticipated its first dividend since 2003, and in paying it Invensys marked a milestone in its rehabilitation. The company, which provides software, machinery and services to control and automate industrial, rail and domestic equipment, also paid off its debts.

Its £4 billion pension fund deficit and the impact of recession may explain why Invensys shares have declined in the last year, but the business is in good shape.

⊙ Advanced Medical Solutions (AMS)

Tipping price: 10.25p

Price now: 24p

52-week high/low: 37.25p/23.5p

Although AMS's share price has fallen this year, confidence should be growing. It has raised profits over four years, and AMS's chairman, while admitting that some customers were deferring spending during the first half of 2009, expects the orders to come in the second half of this year. Its films, foams, gels and alginates are used in the treatment of ulcers and pressure sores, and the company plans to launch LiquiBand, an adhesive that closes and seals wounds, in the US.


Investors may have lost some confidence after a takeover attempt failed in April, and at the prospect of a £4.6 million move into bigger premises during 2009 and 2010, but with its shares costing just 11 times earnings and its absence of debt, AMS is worth considering.

⊙ Hidefield Gold (HIF)

Tipping price: 8.5p

Price now: 1p

52-week high/low: 3.75p/1p

Hidefield Gold truly is a one penny share. Last year, we said Hidefield might strike gold eventually, but the market was unimpressed. Now, with finance harder to raise and still no gold, the market is four times less impressed. 



North Sea prospects: Dana Petroleum