

# Red Hot Penny Shares<sup>®</sup>

**Where to find the big profits in the UK's most exciting share market**

Shares recommended may be small company shares. These can be relatively illiquid and hard to trade making them riskier than other investments. Please seek independent personal advice if necessary.

## Your once-in-a-lifetime chance at 'super-normal profits'... with Red Hot small companies



Tom Bulford

Dear Reader,

In a moment, I'll tell you about one small company that could multiply in value on the back of a powerful new trend that's taking shape in the technology and energy sectors. I'm also introducing a great little way to add some gold exposure to your portfolio. This one has a great story... and it could make you a whopping 300% in the next 12 months. But before we get to this month's new recommendations, let's catch up on what's been happening in our thrilling small cap market.

In last month's issue I wrote: 'The tide will turn. Cash will start to flow in the direction of small companies once more... and when this happens the recovery of this part of the stock market will be swift.' Since then, the small company section of the London Stock Market, as measured by the index of AIM stocks, has risen by 13% making a total gain of 25% since the low point of 9 March. In contrast, the FTSE All-Share index has only risen by 5.5% and 17% respectively.

You have to be 'in it to win it' and those brave enough to have been in it have enjoyed some astonishing share price gains. In April alone, the share price of **Braemore Resources**, for example, has risen by 93%. Other rises were as follows – **Velosi** 66%, **Akers Biosciences** 32%, **Gulf Keystone** 31%, **Powerflute** 33%. Those cash-rich companies that I tipped in the last issue – **Advanced Computer Software**, up 61% and **Genetix**, up 27% – have joined the party. But, the extent of the market's rally is due to something more than investors simply seeking out relatively safe plays such as these.

### Buyers > Sellers = Positive change from irrational to rational investing

What has turned the tide? It is only human nature to want to find explanations for events. We cannot believe in ghosts or the Loch Ness monster unless we can explain how they come to be, and if we cannot do so then we do not trust that they really exist. So inevitably, lots of explanations are now being offered for this big stock market rally.

Low interest rates on deposit accounts have caused savers to seek better returns elsewhere. The Government, desperate to hang on to power, has thrown unprecedented amounts of our children and grandchildren's money at today's problem in the hopes that some of it may stick and help ease the recession. The risk of a total meltdown of the banking sector has receded. Commodity prices have rallied. The pound has picked up on the foreign exchange market. And there are a few of those green shoots appearing in the housing market and elsewhere.

But I don't think that any of those things is the real cause of the rally. Attending a big investment show in London last weekend, I spoke to several small company executives. Many of them complained that their company's share price had been beaten down by a particular fund manager's involuntary selling. He had been forced to raise cash with which to pay out his customers. This forced selling has clearly been a big factor in the decline of the market, but now this seems to be on the wane.

Selling is drying up – the number of buyers exceeds the number of sellers for the first time for several

*please turn over...*

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**Next issue: 6 June 2009**

# This fast-growing, cash-generative business is making a £1.8m operating profit... and could double its share price in a year

**BUY**

**D**id you ever realise that out of the £40 it costs for a day pass into a theme park, about £25 of that will tick away while standing in a long queue? The ride will last for about two minutes. The rest of the day will be spent traipsing around or consuming overpriced chips and fizzy drinks. All of this has something to do with the powers of marketing – the guilt we feel towards our children and a thrill-seeking desire in our lives.

In any case, nobody yet has managed to find a way of making queuing anything other than a complete bore and waste of time. So, any company that can help to eliminate what the Americans call the 'line-up' is doing us all a service. But there is a little more to this than just the quality of our lives. From the perspective of the theme park owner, the time you spend in that queue is time spent wondering whether it was such a great idea to come to the park in the first place. And of course, it is time that you could be spending enjoying some of the park's other attractions, buying food or perhaps even choosing between the fridge magnets in the souvenir shop!

## An exciting opportunity in this undervalued company...

There's one company that has spent a decade devising a solution to this quandary... it is the aptly named **Lo-Q** (ticker: **LOQ**). Last week, I went down to Henley to meet Chief Executive Jeff McManus. Despite his strong efforts to put a conservative spin on Lo-Q's prospects, and with due deference to such threats as the global recession and Mexican flu, there is no doubt that they are very bright. Equally important, the share price is about half of what it should be.

Since not many of us have managed to resist the lure of Alton Towers, Thorpe Park or one of the many branches of Disneyland, I am guessing that you have savoured the delights of the theme park experience. Or if you haven't, you probably know someone who has. You're probably familiar with one or other queue-busting techniques. Whether you go to a UK park where you can buy a ticket that gives you a time slot for a certain ride, or to Disney where you can use your ticket to secure fast track entry, most parks have at least acknowledged the queuing problem. And they've tried to do something about it.

But most queue-busting techniques essentially do the same thing. They allow you to book a privileged place at the head of the queue. The consequence of this is that the queue for the ordinary punter takes even longer than it otherwise would. This is not especially fair, and not many of us can resist a twinge of resentment as others muscle their way to the front of the line.

## Lo-Q's interactive device takes the hassle out of waiting

Lo-Q's system was founded by Leonard Sim after what must be the ultimate bad queuing experience in Florida. After standing in line for two hours, he found that the ride had broken down. The micro-electronics specialist decided to do something about this blind waiting-in-line and is the inventor of a device called the Q-Bot. I will explain what this is in a second, but here's the essential point that distinguishes the system based upon the Q-Bot...

Unlike other systems, it does not give users a place at the front of the queue. Instead, it makes you wait just



LO-Q: THE FACTS					
Year to end December	Turnover £m	Pre-tax profit £m	Earnings pence	P/E	Yield (%)
2007A	7.8	0.55	3.5	19.3	0.0%
2008A	13.5	1.85	12	5.6	0.0%
2009E	19.1	2.1	13.2	5.1	0.0%
2010E	23.2	2.5	15	4.5	0.0%

Source: RHPS/Digitallook

- Latest Bid/Mid/Offer: 65, 67.5, 70
- Bid Break Even: 7%
- Shares in Issue (m): 15.3
- NAV(p): 22
- Epic code: LOQ
- Website: www.lo-q.com
- Normal Market Size: 500
- Limit Buy Price: 75
- 12-month Price Target: 150
- Market Cap (£m): 10.3
- Price/NAV: 3.07
- Market: AIM
- Risk Rating: Low
- 52 week High/Low: 69.5p-16.5p

as long as you would if you were standing in line – but enables you to wander off until your turn comes. As such it is a more equitable system than others as well as allowing you to pass those waiting minutes shelling out your money elsewhere in the park.

The Q-Bot is a pocket-sized device with a small screen. Its basic function allows you to scroll through the rides, picking out the ones you want to enjoy, and it then allows you to join a virtual queue. When your time comes, it will vibrate or bleep and off you go for your spin along the Wall of Death or whatever it may be. This alone is pretty neat, but the Q-Bot has one other feature not shared by ticket-based systems. It is interactive. It is a device that can feed information about, for instance, show-times or discounted meal offers to park goers and allow them to respond.

So it has several advantages over the alternatives and what really counts is that park owners seem to agree. There are about 200 theme parks in the world and Lo-Q is now serving 15 of them.

Ten of these are owned by the Six Flags group, which has 20 theme parks in the USA, Mexico and Canada. Last November, Chief Executive Mark Shapiro described the Lo-Q system in a presentation to Wall Street analysts (which you can find on the Six Flags corporate website). The company branded the system as 'Flash Pass' and Shapiro said it was 'unbelievable', adding that 'it really drove their business'. "We had one million more people throughout our parks using Flash Pass last year," continued Shapiro, "and we plan to install it in two more of our parks this year."

Shapiro went on to say that the Lo-Q system drives revenues in two ways. First because, as I have already said, customers are not 'trapped in line' but are free to roam the park. But also because they pay for the service. Typically they would pay \$20-\$30 for the Flash Pass, on top of their standard entry ticket into the park, and this revenue is split between the park owner and Lo-Q.

### **Strong potential for new contracts and another great device could boost growth**

In the last 16 months, Lo-Q added five new customers. Now, along with the Six Flags group, it has its system installed at Dreamworld on Australia's Gold Coast, Parque Reunidos in Italy, Legoland at Windsor and a park that at least sounds like fun – 'Dollywood' in Tennessee. It also has a mobile phone-based text message system installed at the smaller Flamingo Land theme park in Yorkshire. These contracts are important in themselves but they also attract attention throughout the industry and are an entry into big groups. The owner of Legoland, for example, is the privately-owned Merlin Entertainments group and it is reasonable to expect that if it is happy with the experience of

employing the Q-Bot at Legoland, Windsor, then it will introduce it into some of its other properties. This includes Thorpe Park, Alton Towers, and three other Legolands overseas.

Lo-Q has never had a better list of potential new customers and this will be one source of growth. But there are other possibilities too. One is a new device that will be fully waterproof and thus suited to increasingly popular water parks. Another is to increase the take-up of the Q-Bot, which last year was used by 6% of all park visitors. Prices for the Q-Bot have been quietly raised and may yet go higher, especially if Lo-Q is able to make it even more essential to a successful day out. And then, there are two other factors that could in fairness go either way.

Clearly the number of people who go through the turnstiles of each park is important, and this may be influenced by the economic climate. And finally, with the majority of Lo-Q's money earned overseas its value to the UK investor is going to be influenced by the exchange rate of the pound.

Basically, though, this is a fast-growing company with a product that makes great commercial sense, both for Lo-Q itself but also for the theme park owners who do not pay for the installation of the system (which is generally financed by a leasing arrangement) but still get a slice of the revenue that it generates both directly and indirectly. All this is certainly not reflected in the share price.

Last year Lo-Q made a profit before tax of £1.85m – more than three times the level of 2007. It also increased its pile of cash in the bank – it has no debt – from £630,000 to £2.56m. Deducting this cash from Lo-Q's stock market value of £10.3m, we have a fast-growing, cash generative business that is making an operating profit of £1.8m and is valued at just £8m. Even in the unlikely event that it fails to grow this year, a fairer value for Lo-Q would be more like £20m. That implies that the share price should at least double from today's level.

**RHPS Verdict: After 10 years spent developing the Q-Bot and convincing theme park owners of its merits, Lo-Q is now demonstrably winning new customers and running a highly profitable business. The only fly in the ointment is the financial condition of Six Flags, which needs to refinance its debt over the next couple of months. I think it is likely that it will succeed and if it does not, then its theme parks will most likely continue under new ownership. Any hiatus at Lo-Q's key customer clearly poses some risk, but assuming that Six Flags is able to carry on uninterrupted, I expect the share price of Lo-Q to double within a year. With a 12 month price target of 150p, BUY.**