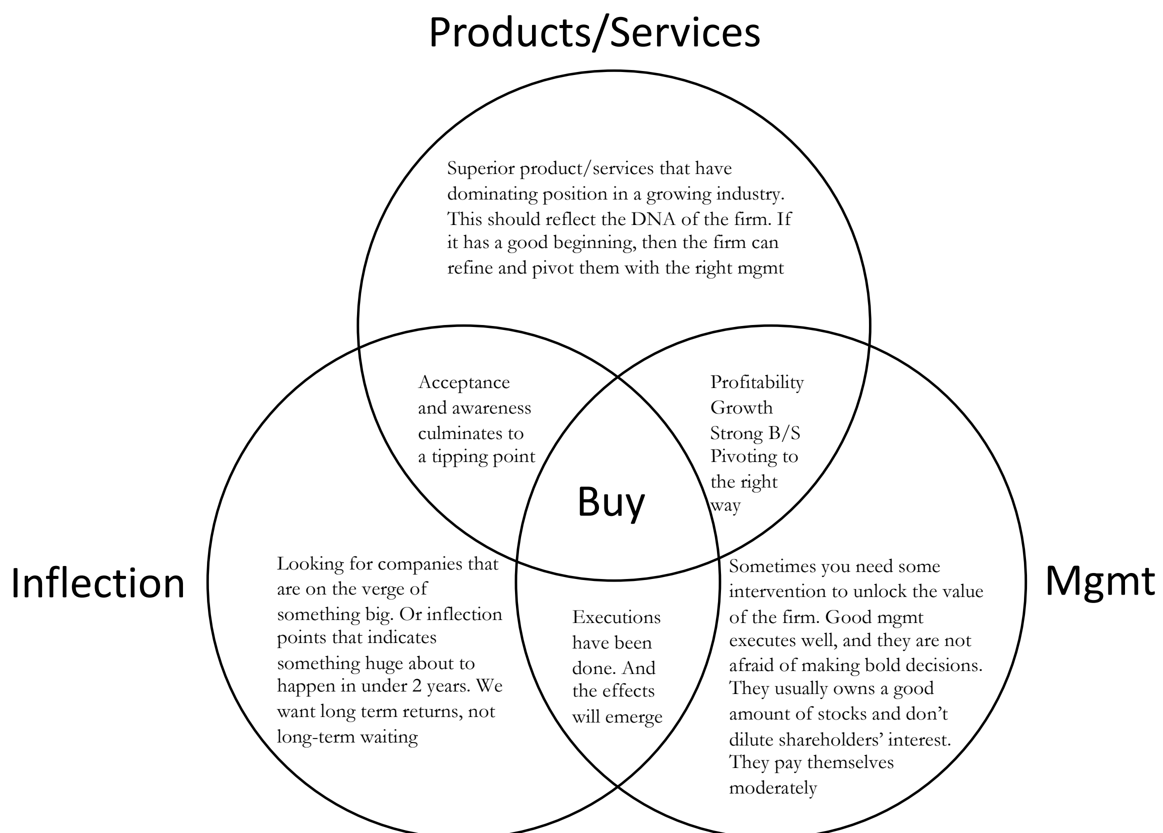
Case study

100-baggers are possible in the microcap realm. Upon studying a list of 100-baggers (see appendix), I have found some common factors these companies share. Although case studies like this tend to be interpreting success stories from the hindsight, I believe we can learn something and apply it to our screening/sourcing/researching process and make money from the foresight.

There are three critical factors that will construct a compelling investment opportunity: Products/Services, Management, and Inflection.



Quality Products[1] that Dominates Growing Markets

Yes, it sounds very boiler-plate-ty, but the 100-baggers do offer super quality products that are at least 10x better than that of incumbents. And these companies usually start out with a very good "DNA". Founders that have deep knowledge about a field have a better chance of producing quality products because they have the expertise to make significant improvements over existing products. However, these founders might not necessarily good at running a company, that is why we will discuss the critical role the management plays. Having a good DNA allows successful turnarounds—be it pivoting, introducing new products, expanding sales force, ridding of value-trapping managements, etc.

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1 I'm focusing solely on products because we rarely see explosive startups that purely offer services. Anything-as-a-Service is still a product by definition but a service by function. Also, traditional services do not benefit from economies of scale because the only way to grow sales is to increase the labor input, which will keep the margin constant and the growth linear, rather than exponential.

However, many investors—myself included—have the tendency to draw conclusions from first impressions because our brains our wired to take mental shortcuts. We will miss 100-bagger opportunities if we misunderstand and ignore the products from the very beginning.

Now, consider you are in 2011, and you pop up a company's filing. You see this:

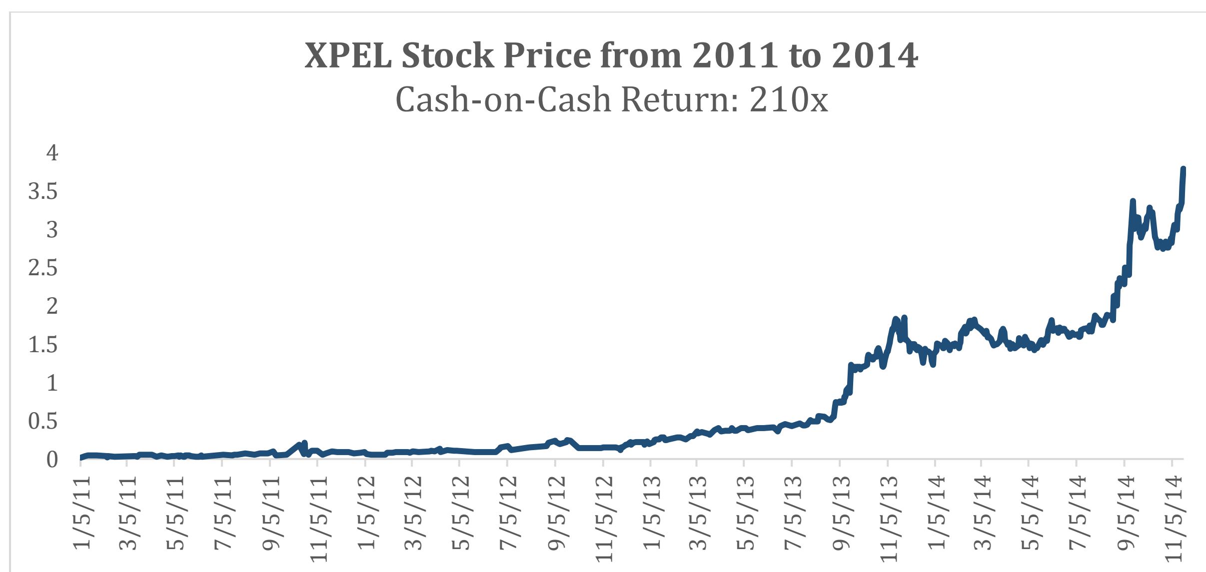
> *The Company manufactures, sells and distributes after-market automotive products. The focus of the Company is the aftermarket for automotive paint and headlight protection products and window tint products.*
>
> *The Company provides all training, equipment and product needed to operate in the Paint Protection industry and broader automotive protection space, including Paint and Headlamp Protection Film and software to access [redacted]'s library of protection patterns. The Company also provides pre-cut paint and headlamp protection kits to wholesale and retail customers and operates a retail installation facility.*

What would be your first impression? Here's mine:

"Hmm, seems like they are selling boring commodities in a highly competitive industry… Any Chinese manufacturer will squeeze the company out of the business on pricing… Automotive? Ugh, cyclical. Oh, they have a software to access a database of patterns? Cool, but who cares? NEXT!"

I bet many people back then passed on the company after glancing at the business description. Even if you read more into its not-so-detailed filings, the company does not look like a compelling investment.

However, if you are active in the microcap space, you'd know this company is XPEL. If you know it's XPEL, you must know that it's a 100-bagger (in fact, 200-bagger, depends on how you select the time period).



Source: stock price data provided by TIKR

There must be something awesome about the products that the company offers. Investors who cared to talk to a few car enthusiasts would know how dominating XPEL's products are.

And the growth really took off in 2011 when the company introduced a new protection film that has self-healing capabilities. This is why a good DNA is important. Quality products helps bring in revenue that keeps small and undercapitalized firms afloat. And if these companies can survive for long enough, and they continuously improve the same products for decades, we should expect the differentiated quality or breakthroughs.

But what if we are dealing with non-consumer facing companies? It would be hard to do the scuttlebutt due diligence. How can we understand the quality and the potential of the products?

Good news is, you don't need to chase down the rabbit hole trying to understand all the specifications and metrics pertain to the product. Because someone understands. And if the product is the best in class, people who buy it must know. And who usually require and have the capability to identify and buy quality products? Blue-chip companies. Reputable institutions. Governments. The experts of the industry.

If we dig the press releases, we will see some impressive headlines:

- XPEL Designated as 3M-Certified Training Facility
- XPEL Distributor Authorized by European Original Equipment Manufacturer; TVR Vehicles Used in Hollywood Motion Pictures
- 3M Film Distributors Partner With XPEL
- XPEL Aligns with Prime NASCAR Vendor
- UnitedAuto Group Chooses XPEL
- XPEL Headlight Products a Requirement for All GT Series Race Car Entries
- XPEL Announces Official Partnership with the Rolex Sports Car Series and Grand-Am
- MARS International Selects XPEL as Sole Source for Paint Protection Film
- XPEL and Paintshield Announce Partnership with Porsche Club Great Britain

All of these happened before 2011. The company was still under the radar given its microcap status and its Canadian listing. However, these headlines speak for the quality of the products.

Solely having great products should not make a company an attractive investment, nonetheless. Wrong managements will destroy the value and advantages these products have. Therefore, having the right people is critical to unlock and augment the values of great products.

Competent Managements with Skin in the Game

Great products don't sell themselves. This concept is illustrated well enough in Peter Thiel's *Zero to One*. Competent managements know the products and their potentials very well, and they also know their firms very well. They are excellent capital allocators. They know

how to allocate resources to maximize their businesses' potentials, even if that means their actions instigate controversies from peers and the Wall Street.

When great managements meet great products, we will see growth, profitability, healthy balance sheets, and a bright future.

Unfortunately, not many companies with great products start out with great managements. Therefore, external interventions to the management/board can be a signal for turnarounds. We need to figure out the new captain's track record and patiently observe their actions post-takeover to determine whether we can potentially entrust our money to them. Alignment with shareholders can be seen through their holdings and incentive structure—this is a relatively simple work for investors to do their due diligence as related information are readily available online.

Competent leaders don't get comfortable with the status quo. They are risk-takers.

Consider the case of BioSyent (BIOYF). In late 1990s, the company was named Hedley Technologies with one core product, Protect-It, a pesticide. We can already see the quality DNA of the firm through the exponential sales growth. People loved Protect-It. The product sold well worldwide. In 1997, the sales were up four-fold!

Clearly, Protect-It became a cash cow for the company. The management, however, became comfortable with it. Until 2003, no strategic progresses were made. Most of the cash still came from Protect-It. The old management team was paying themselves handsomely year after year even though the sales keeps declining since 1999.

In 2004, the old team resigned, possible under the pressure of shareholders. Rene Goehrum took the throne, and he saw the problem. The pesticide business was too cyclical with many uncontrollable yet impactful variables like weather. Rene had extensive and successful entrepreneurial experience along with careers at blue-chip companies like Kraft Foods and Proctor & Gamble. As previously a COO of the firm, he's seen the day-to-days of the business. And he saw where to pivot the company.

Rene decided to make an inroad to the pharmaceutical industry in Canada. This was a bold decision. Sure, the pesticide business was cyclical, but Protect-It still dominated the market. If not careful, the decision would undermine the success the company took decades to build. Rene understood the risk he's taking. So, his strategy was to source proven drugs with good potential and acquire or in-license those drugs from pharma companies. He wanted to leverage his and the company's experience in sales, distributions, and regulatory clearance processes to commercialize those acquired drugs by getting them through the government approvals, which can be lengthy and costly for inexperienced or small drug makers.

However, this was a new territory to BioSyent. Knowledge and money were required for this transition. Rene did a very brilliant thing: he bought the right to distribute some HIV diagnostic device and started selling and distributing them in Canada to test the water. After having a good sense of the key players and the market dynamics, he sold the right back to the manufacturer, profiting $1 million from the transaction (he increased the value of the

device because of his excellent sales skills). With knowledge and money in hands, Rene started his adventure.

One year later, the company stopped further investment in the pesticide business and BioSyent was created as a subsidiary for the pharma business. In 2006, the company launched FeraMAX in Canada. In 2007, FeraMAX started shipments. Rene continued building out distribution infrastructures with healthcare providers in Canada to prepare the launch of hospital products. In 2009, the company was signing multiple sales/distribution agreements.

From 2007 to 2009, due to the initial investments and the global recession, the company booked losses. Yet, as the pharma division gradually took more sales mix, the company took off in 2010 with 60%+ sales growth. 67% after that. 79% after that. If one bought the stock in 2010, he or she would realize a 17000% return in 2015.

Note that since 2004, shares outstanding has only increased from 12 million to under 13 million in 2019. Rene is still with the company and he's still buying back shares. And he's the largest shareholder owning 13% of the company.

Inflection Points

It's great if you can find a company with both great products and managements. However, this combination alone does not constitute a compelling investment opportunity. If the competent leaders have been successfully executing the strategies for a while, people have probably found out about the company and bid up the price. And at this point, it is even hard for the company to continue its growth. That would severely limit our upsides while creating risks from valuation contractions. In other words, we might be too late in the game.

Conversely, if the management has just planned out or started its strategies, we never know how long and how much money it takes to successfully grow the company. Great managements fail, too. If we are too early in the game, we might wait for years to see the result. Even if the result is great, the opportunity cost is quite expensive on a multi-year time horizon.

By finding out inflection points, investors can protect their downside and underwrite their investments with a higher level of confidence.

For example, Tom Cleveland became the CEO of Patrick Industries in 2008. He took on the tasks of cleaning up the messes previous managements have done to this quality business. He paid off debts quickly, divested non-core businesses, flattened bloated corporate cost structure, closed inefficient plants, and started acquisitions that aimed to strengthen and diversify the company's product lines.

The company is a supplier to the Manufactured Houses and Recreational Vehicles industries. Clearly, these are two cyclical sectors. Tom's plan was to reduce the exposure to the MH sector while strengthening its dominating position in the RV business.

In 2009, the business was still losing money. However, one year later, Tom's executions made the business profitable. Investors who was following the company should see this as a perfect inflection point because 1) Tom had proved his competency and that his strategies were working, 2) the company was profitable now with 30% revenue growth, and 3) the MH and RV industries had just started to recover from the bottom.

Investors who saw this transition at the end of 2010 and made an investment in the company would make 10x of the money in two years, 20x in three years, 30x in four years, and almost 100x by 2018. These returns are incredible for a company that operates in cyclical industries.

Appendix

List of 100-baggers: https://microcapclub.com/wp-content/uploads/2015/06/10-baggers-in-five-years-Clean.pdf

Some common factors I found:

- **Quality products that dominate markets with significant growth runway**
- **Have long history with shareholder friendly approaches during bad times**
- **Managements have skin in the game and have shown their faith in the company**
- **Some pivoting moments happened to unlock the value of the firm by either creating new products, increase sales effort, or enter into new markets with new distributors etc.**
- **Quality distribution channels and agreements with giants**
- **Private placements with insider participants**
- **They all turned profitability with high growth at some point**

Most important takeaway: do case studies.