Chapter One

The Classic Under $10 Stock

A Darling with a Record of Breakout Profits

WHEN I AM ASKED ABOUT THE PERFECT SINGLE-DIGIT stock, I like to tell the story of a company called Darling International (DAR). You could call it the classic under $10 stock. You see Darling is in a business that literally stinks; they collect the used cooking oil and grease from restaurants all over the United States as one part of their business. Another division of the company stops at slaughterhouses and butcher shops to collect hides, bones, and other animal by-products. What on earth did they do with what they collected? In a nutshell, they turned all the messy unusable stuff they picked up into useable products. This is hardly a glamorous business.

But I thought it was a very exciting business when I came across the stock back in late 2008. The stock got crushed along with everything else in the market, falling from around $16 earlier in the year. The stock kept falling, eventually bottoming at around $4 in November of 2008. The company had never been widely followed on Wall Street, but now no one cared about the company at all it seemed. But not me; I smelled opportunity and took a closer look at the company.

As near as I could determine, Darling was the only rendering and collection company that was national in scope and capability. Their competitors were small, locally-owned companies that could not compete with the economies of scale Darling was able to achieve. At the time the company had 39 facilities around the United States and 970 trucks and tractor-trailers collecting raw materials from 115,000 different locations. Most of their raw materials customers were on long-term contracts, so they had a stable supply of raw materials.

In addition to having a competitive advantage over most of its competitors Darling was not averse to simply buying them either. When I looked at the bottom line what was very clear was that by both acquisition and organic means this company was growing fairly rapidly.

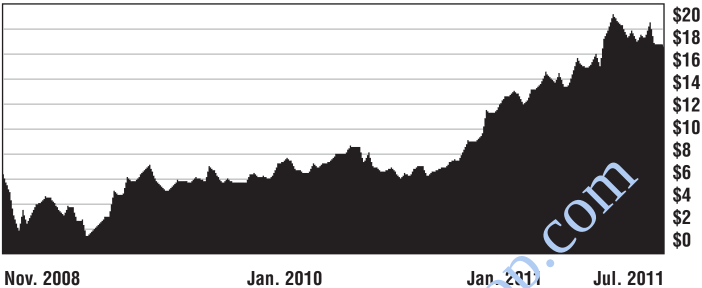
Revenues at Darling had nearly doubled from $323 million in 2003 to $645 million by the end of 2007. Net profits had risen sharply as well reaching $45 million compared to about $18 million just four years earlier. The earnings per share had almost doubled from $.29 a share to $.59 at year-end. Darling had doubled its asset base over the four years and paid down their long-term debt over the same time period. The company was not slowing in 2008 either. In the first half of 2008 the company had year-over-year revenues of $422 million compared to $298 million and earnings per share of $.55, compared to only $.29 a share in 2007.

Darling may be in a stinky business, but it is one profitable company. In spite of this, by the end of 2008 the stock was solidly in the single digits, trading at $5 and change. I had to know more, so I dug into the filings and reports from the company. When I did, I quickly discovered that Darling was moving into alternative energy areas where the collected grease could be used as a source of biofuel. Now from what I saw, if the recession deepened, it was likely that the company would see some pricing pressure as demand for its end products slowed, but it was clear that the demand would not permanently be destroyed. By the end of the year the stock price slipped under $5 and it was clear to me that it was time to buy.

I didn't catch the exact low, but I was close. Darling saw some revenue declines throughout 2009 but this was more than priced into the shares at that point. Revenues declined year over year but by the fourth quarter the company was back on track and end market demand was picking up. In September of 2009 they announced a new renewable fuels venture with Valero Energy, a major oil refiner. The stock price almost doubled by the end of 2009, to around eight bucks a share. By midyear 2010 the stock price was back over $10, and it never looked back. As of July 2011, the stock is all the way back up near the pre-crisis highs for a return of over 300 percent. (See Exhibit 1.1.)

Darling International was misunderstood, underfollowed by Wall Street, and in a decidedly unpopular industry. The few analysts following the stock had too much focus on the short-term considerations of the recession's impact on the business and totally missed the big picture! Not only did Darling have a great business already in place, but its move into the renewable energy field was going to bring the company increased attention. Investors who saw the breakout potential of this company's stock could

Exhibit 1.1 Darling's Breakout Performance



have seen short-term returns near 100 percent, and those with a longer-term perspective could hold on and more than triple their money in a little over two years.

Finding Your Darlings

In this book, my goal is to help you find your Darlings. After two decades of investing, I can tell you that low-priced stocks are a great way to build, or rebuild, your wealth. Many of my biggest winning stocks over the years started out as single-digit priced stocks. They were stocks that were off Wall Street's radar screens for a variety of reasons, but once the Street and large institutional investors discovered them, they often soared in price.

And make no mistake; that's one of the benefits of investing in stocks under $10. It's simply easier for a $10 stock to go to $15 than a $50 stock to go to $100. In fact, it's why you'll hear me refer to the best low-priced stocks in this little book as *breakout stocks*.

Breakout stocks may be excellent companies that are down in price simply because investors sold while they were selling everything else—the proverbial baby that was thrown out with the bath water. Or they may be companies engaged in dramatic turnarounds that will soon catch the attention of investors. Or they may be a brand new company with incredible potential that hasn't been discovered yet by Wall Street.

Breakout stocks can come in all kinds of shapes and sizes, but there are three things they all share:

1. Low-priced (mainly under $10).
2. Undervalued.
3. Have specific catalysts in the near future that put them on the threshold of breaking out to much higher prices.

When they do begin to break out, the snowball effect kicks in as institutions climb on board and drive the price of shares even higher. That's when we, as investors, make a lot of money.

The key, of course, is to figure out if a stock is truly a breakout stock or instead a broken stock. Wall Street would have you believe that all under $10 stocks are dogs. That is simply not the case. That means we have an exciting number of opportunities available. But there are some dangers as well. Many stocks under $10 are cheap because they deserve to be. They are dogs that never had potential, were permanently damaged by the recession, or have misstepped so badly they have no hope of getting back on track. In the pages ahead, I'll show you how to sort the wheat from the chaff.

In today's market, it is hard for individual investors to compete with all the large mutual funds and computerized investors but, as I'll show you, low-priced stocks are one segment of the market where you have a huge advantage. Shall we begin?

Breakout Tip: Keep an Eye Out

I've done my best to cram as much valuable information into this little book for you as I can. But as you read along, I want you to keep an eye out for this computer screen symbol.

That means I've posted additional information for you at a special website for readers of this book www.bigprofitsfromsmallstocks.com. This site is packed with additional tip sheets, interactive videos,

(*Continued*)

and even the names of a handful of stock recommendations to help you begin to build a portfolio of small stocks for big profits.

And for you smartphone or tablet users, I've even included some interactive Quick Response (QR) codes as a way for you to receive instant advice from me on your device, as you read along. They'll look something like this:

If you have a smartphone or tablet device, but have never used these codes, they're easy (and fun!) to use. See the Appendix at the back of this book for more.

And finally, I've included quick summary sections—just like the one you're reading now—at the end of each chapter for easy future referral. That way, this little book can continue to be an important reference tool for you, not just as you're reading it, but for as long as you're looking to invest in low-priced small stocks. Happy low-priced stock hunting!