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## UCORE'S BOKAN MINE

### Largest U.S. Heavy Rare Earth Deposit:

*Critical to American Clean Energy*

## Investing in the Green Economy

By Todd Pitcher [6]

## Geothermal Energy-Heating Up

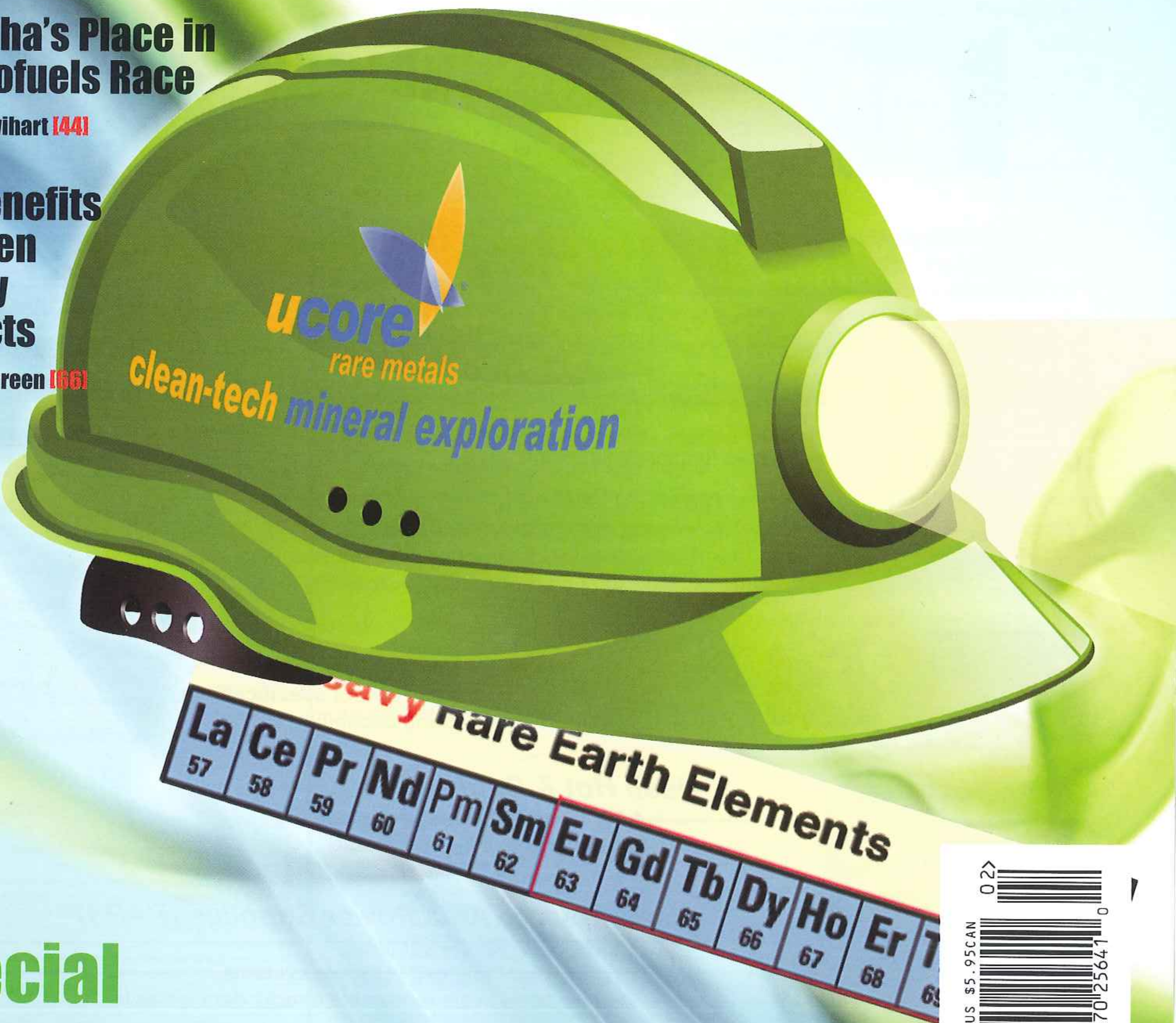
By Larry Turel [37]

## Jatropha's Place in the Biofuels Race

By Lissa Swihart [44]

## Tax Benefits of Green Energy Projects

By Robert Green [66]




## Special Green Issue

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# A Clean Balance Sheet Can Help a Company in More Ways Than One

## *Companies can help their cause with more than just investor relations*

When publicly-traded companies try to achieve break-through performance and increase their stock price, they generally focus first on improving operations or public relations. An area often overlooked is financial reporting. Managers too often ignore the importance of having a strong balance sheet. Without having a clean balance sheet, however, achieving the aforementioned goals often is futile.

A balance sheet tells a lot about the health of a company, especially its liquidity and solvency, two areas that investors are keen on. Carrying more debt on the balance sheet will require the company to use more working capital and revenue to pay off that debt. Using cash to service debt siphons away money that can be used to re-invest in the overall growth of the company. In some cases, high debt levels will force companies to issue more shares to raise money for working capital. Issuing shares is dilutive to the company and drives the stock price lower.

A company with high debt is like a person with a lot of credit cards. People with high credit card debt will need to use a higher proportion of their personal earnings to pay off that debt. Hence, individuals or families with a lot of credit card debt often see their living standards decline.

■ BY JAMES DEPELISI

The same idea applies to a publicly-traded company. What is even more concerning about a company carrying excessive debt (compared to revenue or cash reserves on their balance sheet) is that the company attracts the wrong kind of people to its stock.

Most Wall Street analysts gauge the success of a company based on its ability to generate high earnings per share (EPS) and return on equity (ROE).

Interest expenses associated with debt can hurt earnings per share. Additionally, one of the quickest ways to gauge whether a company is an asset creator, cash consumer, or debt accumulator is to look at the return on equity.

Wall Street typically does not place a high value on stocks of companies with significant debt on the balance sheet, a low ROE, and a low EPS. Traders and investors calculate the likelihood that the price of such stocks will go down instead of up. In many cases, the negative outlook attracts short sellers to a company's stock. Even when a company cannot post positive earnings, short sellers in a company's stock will not be frightened by the risk of having to cover their short selling positions. Ultimately, this drives micro-cap stocks down to penny stocks.

What then is the answer? Companies need to rid their balance sheet of unnecessary debt. If the perfect situation of zero debt on the balance sheet is unrealistic, a company should try at least to have more cash or revenue compared to debt on the balance sheet.

How do companies clean up their balance sheet? They do so by restructuring the existing debt.

There are several ways to restructure debt:

1. If cash is not an issue, the company can negotiate with note holders to retire the debt with cash. In some cases, the company can convince note holders to accept a settlement at a discount.

2. If a company is cash-strapped, it can give stock to note holders in exchange for their debt.

3. Contingent on its asset base, a company can swap convertible debt into bank debt to reduce the overall debt on the balance sheet. The company uses no cash, and the notes have more intrinsic value backed by the assets of the company.

4. The company can negotiate with note holders to extend maturity dates of the principal and/or interest payments.

A company with a clean balance sheet can put itself in a better position to create opportunities for the future. This helps a company in more ways than one, especially if it can post positive earnings per share and return on equity. ■

### ABOUT THE AUTHOR

James DePelisi is the president and founder of LDV Capital Management, a registered investment advisory firm based in Florida. LDV Capital Management offers investment banking services with a focus on balance sheet clean-up, institutional capitalization, fairness opinions, valuations, financial advisory, and merger and acquisition work. The company also provides services for financial statement preparation for 10Q,10K,S-1,S-3,and Form 10 filings. More information about the company can be obtained by calling (954) 746-3117 or sending an e-mail to Jim@LdvCapitalManagement.com. The firm's Web site is www.LdvCapitalManagement.com.