Quipp Systems, Inc.

QUIP (US: NASDAQ)

Report as of November, 17th 2006

Investment Failure

First Purchase: Fall of 2004 @ ~$13.50/share
Additional Purchase: Added gradually from $10 continuing down to $7
Last Sale: None
Current Price: ~$7.50/share

Company Background:

Quipp Systems, Inc is a niche newspaper equipment manufacturer based in Florida. Quipp specializes in post press equipment (both design and installation) for the newspaper industry.

Investment Thesis:

When Quipp stock was trading around $13.50/share, the market value of the entire firm was approximately $19 Million (based on 1.43 Million shares of stock outstanding). For this $19 Million price tag, you could get a company with the following characteristics:

1) 80-90% market share in a small niche market of the newspaper industry
2) Historical earning power of $3-5 Million ($2.00-3.50/share)
3) Strong Balance sheet – nearly $8 Million in cash ($5.50/share)
4) Possibility of improving business results due to the cyclicality of the newspaper industry

Why was the Stock so Cheap?

Several reasons contributed to Quipp shares selling at a discount, and there was a good chance that within a reasonable timeframe, the market would see through these issues and value the company at a fair price.

1) The business had limited growth prospects.
2) The company was not doing anything with its excess cash.
3) At the time was company was making minimal profit, operating mostly at breakeven.
4) The company had a "poison pill" in place which forced any investor group to limit their stake in the company to less than 10% of the shares outstanding.
5) There were questions if the newspaper industry would ever turn around enough to make Quipp profitable again.

Laying the Concerns to Rest:

However, with a little digging, these concerns could be laid to rest.

1) The business did have limited growth prospects, but there was still opportunity to make good money on existing business and return excess cash back to shareholders via dividends and share buybacks.
2) The company was indeed sitting on excess cash, but they did perform a Dutch auction for their shares in the past and there was a possibility they would do it again.
3) The lack of profitability was concerning, but the company was not at risk of losing large sums of money, and it had proven very profitable in the past.
4) While the poison pill did limit large investor interest, it was not preventing a company from making an offer to take Quipp private at a premium price.

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5) The downfall of the newspaper industry is in progress, and I don't believe anything can alter that, but I thought the time at which it will take this to happen, and profitability of the entire industry during this period are drastically understated.

All these reasons, coupled with the fact that Quipp is for the most part, a company no one had ever heard of, and a company that all Wall Street analysts ignored, meant that there were not a lot of buyers for Quipp's stock, which made it rather cheap and attractive to purchase.

Conclusion:

While I think the analysis to purchase Quipp was solid in general, several factors have contributed to a lowering of the fair value of the company and should have been recognized before the purchase.

1) **Entrenched management –** Quipp has 'honest' management, but at times, management and shareholders are not well aligned. Oftentimes management wants to 'grow' their business and expand into new things to justify their generally rather large salaries… there is little glory (or salary) to be had by bringing a business to its final rightful termination in a profitable manner. After the initial investment in Quipp, the company spent several million dollars on an acquisition ("Newstec") which is looking more and more like a bad acquisition decision every day.
2) **Action speak louder than words -** In addition, management turned down an offer to sell the company at $14.50/share to a private investment firm and instead chose to initiate a $0.05/share dividend. This whole time saying that $14.50/share was too cheap, but neither management nor the company had been out purchasing the stock with their own money.
3) **Cyclicality is very unpredictable –** During the last few years, Quipp's business has continued to be very soft, and profitability has been weak. While the shares are still cheap, there is no catalyst in sight, and for this kind of investment, a catalyst is very important.

Just recently, a private investor (John D Lori) with a 10% Quipp stake has gotten himself onto the board of directors and is urging the company to sell itself. I maintain belief that the company is worth $15 or more, but that value is not increasing with the current management, and it may in fact be decreasing. The exist for this investment is now a buyout or a business environment turnaround. In addition to Mr. Lori, two other 10% investors have emerged. If the company can be convinced to remove its poison pill, or it decides to sell directly, this may end up being a 'fair' investment, but my original thesis was clearly flawed.