

## NEVER FEAR, EARNINGS SEASON IS HERE

To the point, we had a very difficult month of June, with the fund dropping 9.2% versus a relatively benign environment for industrial small caps in general. We really have no specific fundamental explanation for the weakness in the fund. The fund simply “drifted” downwards during the first half of the month and our stocks were unable to “catch a bid” during the rally of the final week; this tends to be a the nature of our companies, as they don’t have enough market awareness or short covering to participate in short-term, market rallies.

Fundamentally, we have little to report as none of the companies we were invested in at the beginning of the month reported anything material in June. We are confident that over the next month, earnings season will bring a plethora of positive developments for our investments. Thus far we have experienced no “earnings warnings” from our investee companies, and our companies generally aren’t well followed enough to give any meaningful forward guidance.

One theme that is developing within the fund is our investment in “outsourcing companies”. We are finding different niches of this sector that don’t really have any other common thread; we believe that this characteristic is one of the main reasons why some of these stocks remain under the radar screen of the market despite good growth, scale, and improving profitability:

- **Call Center:** We are invested in a call center with over \$1BB in revenues and a 5%-10% growth rate. The company is a leader in the field but as they have gone through a transition where they moved business offshore, they lost all of their analyst coverage. The stock trades at \$3.60 per share and we believe they could earn over \$0.50 next year.
- **VOIP provider:** Another interesting company is a full-service VOIP provider that decided to not to provide their service directly to end users (a la Vonage) but rather “white label” their technology for a fixed monthly fee per end user (i.e. Verizon and SBC’s customers). With 8 consecutive record quarters behind them, they have recently turned profitable and we believe the stock is trading at a reasonable 15x expected earnings.
- **Staffing:** We found a gem of a company that has managed, though organic growth and acquisitions, to build a \$100MM staffing agency over the past two years. We believe that the Company could earn as much as \$0.25 over the next twelve months. In addition, this company is in the process of merging with a private payroll processing company that could add another \$0.10 in EPS. The stock currently trades at close to \$1.00.
- **Healthcare:** We have very recently built a substantial position in a company that provides transaction processing services to insurers and other providers for prescription drugs. The company gets paid on a per-script basis and prescription numbers will continue to rise, even if prices decline. We believe that the company, with a current growth rate in excess of 25%, trades at less than 15x earnings.

We have had very little turnover in our stocks and remain largely invested in the same companies with which we entered June. We are currently 90% long and 25% short. Our long positions are split evenly between US and Canadian stocks. Approximately 67% is invested in small cap companies with little or no analyst coverage. Hopefully, a strong earnings season will bring some of these companies to the market’s attention.

Thank-you again for your support,

Brandon Osten, CFA  
President, Venator Capital Management Ltd.