

Mossberg's Investor Digest

Best Idea Profile:

DEQ Systems Corp. (TSX:DEQ.V)

DESCRIPTION:

DEQ specializes in progressive and random bonus technology for table games. What this means is it supports side wagering when players playing a principal game may, in addition to their wager on the principal games, place a side wager in order to have the chance to win additional prizes or jackpots independent of the outcome of the principal game. DEQ's patents and products include side bet bonus with progressive and random jackpot prizes and slot machine-style mystery bonus, multiple credit betting on the player's and dealer's hand, denomination betting flexibility, electronic credit bank, electronic rake, as well as baccarat and blackjack hand tracking systems that provide players with statistical data. DEQ products use multimedia animation and sound effects and are found in more than 275 casinos in more than 30 countries. DEQ is an intellectual-property-focused company with more than 20 patents recognized in 50 countries. It is headquartered in Levis, Canada.

KEY INVESTMENT CONSIDERATIONS:

Recurring Revenue – The number of DEQ's installations has grown 40% since 2009. All five DEQ product lines are focused on table game accretive revenue. The 2,000 units installed in more than 275 casinos generate almost \$7 million in annual recurring revenue on a go-forward basis. In the third quarter 2013, recurring revenue increased 25% year over year, with two-thirds of the installations in the first nine months representing repeat business.

New Opportunities – DEQ's technology is attractive to casino owners as it has the ability to add to the revenue generated per table, as well as increasing player retention to the tables. DEQ has only 10% share of the addressable gaming market and has multiple new products and technologies to take advantage of this strengthening market. In particular, Asia, Canada and the U.S. all represent solid growth markets for DEQ. With the introduction of new products, such as the first Hawk Electronic Baccarat Shoe that was installed in September 2013, and the new EZ Baccarat Online, DEQ will likely be able to capture some additional market share.

Stable Operating Costs – The latest reported quarter showed only a 9% increase in operating costs over the previous year quarter. EBITDA increased 82% in the same time period, on a 25% increase in total revenue. Operating costs going forward are expected to remain stable.

Strong Cash Position – DEQ had \$1.8 million in cash at the end of the third quarter which more than doubled the previous quarter's cash position.

VALUATION:

DEQ's market capitalization of only \$21 million makes this an investment for risk-tolerant investors. There is further uncertainty generated by the vacancy in the chief executive position, although that is mitigated by the strong temporary guidance provided by the former chief financial officer. Despite these risk factors, the company is growing rapidly with additional patents and products in the works, or recently introduced. EBITDA and cash flow are turning positive, and there is an attractive pile of cash.

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Investment Data (as of 2/25/14)

| | |
|--------------------------------|-----------------|
| Recent Price | \$0.24 |
| 52-Week Range | \$0.23 - \$0.43 |
| Fiscal Year End | Nov |
| Dividend | NA |
| Yield | NA |
| Shares Outstanding | 71.7 M |
| Average Trading Volume (3 mos) | 18 k |
| Market Capitalization | \$17.2 M |
| Cash | \$1.8 M |
| Long-term Debt | 0 |
| Enterprise Value (EV) | \$16.9 M |
| Book Value | \$0.13 |
| TTM Revenue | \$6.7 M |
| P/ Revenue | 2.7 x |
| TTM EPS | \$(0.04) |
| P/ EPS | NA |
| TTM EBITDA | \$(119) K |
| EV/ EBITDA | NA |

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