

## **AudioEye:**

Investment thesis:

About six to nine months ago David Moradi (DM) called to tell me he had an interesting private deal that he thought I would be interested in. It would include stock with warrants attached, but I would have to become restricted in the stock. I immediately told him “say no more; I do not want to know anything about this deal because being restricted in any stock is not an option for Tourmaline”. There was no way we could tell our most important partner, Blackstone Senfina, or any other client that we are restricted in a stock. He did say it was highly unlikely that they would ever trade in the stock, but he understood.

Several months later, I went to dinner with DM; as all our dinners go, we mostly talked about his investments. This is when he told me about AudioEye (AEYE). He told me he had been invested in this company for several years and really liked it. He thought they had a market leading technology that could be used by 5% to 10% of the population who are deaf or blind. The example he used is how does a blind person book and use UBER? There is no phone number to call. He also said that there are laws in place or coming as part of the Americans with Disabilities Act (ADA) that would start to force internet sites to provide access for people with these disabilities. Furthermore, one of the members of AEYE board was Tony Coelho who was the primary sponsor of Americans with Disabilities Act. Below is a link that will discuss further ADA compliance and within the article are other links that discuss how large firms like Facebook, Netflix, Southwest Airlines and Target have had lawsuits filed against them for noncompliance to ADA laws.

[technology/the-focus-of-the-ada-turns-to-websites-in-the-digital-age-is-your-website-compliant/](#)

DM also said the management team that used to be in charge at AEYE ran the company poorly. Despite having a great technology they were poor managers and DM felt were running the company into the ground. He used his influence as a large shareholder to remove the old management team and bring in a good management team. He very much likes this management group because they have cut costs significantly to the point that he believes AEYE could be cash flow positive either this year or next if they can grow sales. Also, the new management team are large shareholders and therefore incentivized to run the company in a manner that will benefit all shareholders. AEYE has been adding new sales people, and based on the most recent earnings filing they are adding bookings. They are selling to real companies, for example Mutual of Omaha. You can go the Mutual of Omaha web site and see how it works as well as the AEYE site itself.

Software bookings: In software, and I am sure many other subscription or licensing sales models, companies can only account for sales after the revenue has been received. For example, if AEYE gets a contract to provide their software for a one year deal at a price of \$120,000 they can only recognize income as the revenue is earned over the course of the year. So for Q1, they would book sales of \$30,000 and the remaining \$90,000 would remain deferred income. Why is this important and why does it excite DM and make him believe that AEYE is turning the corner to profitability or EBITDA positive? If they booked

\$1,153,000 as of their August 2 business update, they will probably have total revenue of \$1.5 to \$2.0 million this year.

AEYE is not a get rich quick company. There are no events or near term catalyst that I am buying into. My purchases have been periodic spread over four months. Many days in those months I made no purchases and there was no volume. Yes on some days, my purchases were a large percent of volume, but that is for a few key reasons including the fact that there was no urgency to my purchases and therefore I would place an order on the bid side of the market and wait until a seller would sell me stock at my price. If I was not hit then I did not buy.

AudioEye is simply a company with an interesting product with no real competitors as far as DM knows. The only companies that do what AEYE does are consultant businesses who come in, do work, then leave. DM thinks that if AEYE has revenue of \$2 million for 2016, they could increase to a range of \$4M to \$6M in 2017 and \$8M to \$12M in 2018 and so on. With revenue growth potential like this along with their high gross margins, he believes AEYE is undervalued and over the next several years the stock could rise from the current \$0.15 to \$1.00 to \$2.00 by 2018. An important caveat is that revenues and booking could be very lumpy meaning that some quarters may look good and others may not look so good.

This is clearly not a riskless investment. Technology in software can change quickly. There may be many other companies that exist with better technology in development. But a risk adjusted loss of \$0.15 per share versus a potential gain of \$0.85 to \$1.85 over the next three to five years seems reasonable.

**Why does DM tell me about his investment ideas?**

This is where he and I connect. Frankly he is an odd guy and does not talk much about anything beyond investing. A two hour dinner with him, one on one, feels like 10 hours. I have continued to keep in contact with him because he says he believes that he is going to ramp back up his investments in the public markets soon. Of note, he does not believe that he will ever be anything but a family office because he prefers to invest in smaller underfollowed stocks with more upside potential. I recollect he has said that he has been up significantly since closing Anthion and becoming a family office. He believes his opportunity set is much larger as a smaller more nimble fund and he does not have the distractions of investors.

I have tried to stay in front of DM because, as we all know, he is probably still our largest client or in the top five despite closing his fund several years ago. I believe that DM is very conscious of what is legal and what is not legal in the securities industry and he is very careful to be compliant. He certainly is not going to risk his wealth to try and enrich me. David is overall distrusting of, for the most part, everyone, and in particular, the government.

The question I have, if everyone else thinks DM is not reputable, should we fire him as a client? As far as I know, he has a clean record and has never had any legal issues despite his aggressive investment style.

#### **MY INVESTMENT STRATEGY:**

I have always been an investor. My first investment was a purchase of Fidelity Magellan, managed by legendary investor Peter Lynch, when I was in 8<sup>th</sup> Grade. I have invested ever since. I believe in investing for the long term. I do not believe in short term investments or day trading. I estimate that my average holding period is between five and

ten years. I have attached my largest holdings at the end of this document as an example. I do add to holding I have owned for a long time if the price is right. I also sell sometimes, but very, very rarely. I do not believe anyone has the ability to predict short term moves in any investment and therefore I do not try to invest that way. I like to buy when there is market dislocation as displayed by all the purchases in 2008 and during Q4 of 2015 and Q1 of 2016.

When I make an investment, I view it as buying a small piece of a good business. I own GOOGL at \$793.00 and I own AEYE at \$0.15 and stocks at all different share prices and market capitalizations. The share price and market capitalization are not relevant to me. The financials, the business, and the risk versus return are what I value. I do not care if a stock trades on NASDAQ, NYSE, and OTC, Pink sheets or international.

**An interesting example of an investment:**

March 2006 I bought 1,000,000 shares of Regis Resources at approximately \$0.10 (later had a reverse 10/1 split so the \$.10 now equaled \$1.00) based on the recommendation of one of the best clients of Williams Trading, Boo Callanan who worked at Rubicon. I could not buy the local in Australia RRL AU because my account set up was for US stocks only but I could buy the fungible pink sheet in the US market RGRNF. Interestingly, Henry sat next to me at the time and also made an investment in the local RRL AU.

I have always believed investing alongside your clients in their best ideas shows partnership and trust with them, and also helps keep more focus on their key holdings. If they go out of their way to make a recommendation they are typically convicted. Many of my best investments were recommended to me by clients.

How did the Regis investment work out? Not so well for Boo, in November of 2007 his fund forced him to liquidate his position aggressively driving the stock down to less than \$0.10 -90% from my purchase price. I believe that Henry made money; I do not know how much but I know he has subsequently liquidated his entire position. I also have sold 75% of my position and made money. Here is the important part. Over 10.5 years later and significant volatility I still own 25% of my position at a value of \$2.91 and 180% return. This is a perfect example of how I invest for the long term. This is another example of how I partner with accounts, connect with accounts and I am able to discuss positions that are important to them. This is my edge compared to everyone else.

### **Why do I think Brett bought AEYE?**

Brett is my back up. I have taken him through the character of each account. I point out how they trade and what sort of stocks they trade in. I told him about my dinner with DM and his excitement for AEYE. Furthermore, in an effort to protect against errors, Brett listens too many of my calls with all of our clients so we can double check orders. He has also heard calls between me and DM discussing AEYE. He comes to his own investment decisions and I do not know his process but clearly he invests.

### **Why did Larry buy AEYE?**

I believe Larry overheard some of my discussion about my dinner with DM and asked if I think it was worth buying. I do not recall my response, but I certainly said DM thinks it is his best risk return investment. I also mentioned I may buy some. He did not tell me he

was going to buy any AEYE until months later despite asking about it several times.

Worth noting, about a year ago Larry asked me for a personal meeting because he was doing better financially and wanted to start investing. He said he wanted to start with Ailanthus and ask a few others he covered such as Broad Run. I told him this is a good way to start. It would show partnership with his clients and demonstrate they are all on the same page. Furthermore, I believe that seeing 100% of a funds trades give great transparency into funds who will be successful.

Quite honestly, I was flattered Larry asked, since I realize Larry is bright and can make his own investment decisions. He knows I have recommended funds to East Rock and they are obviously sophisticated investors. If my advice is good enough for them it would be valuable to Larry also. Larry knows I recommended Mangrove and Jericho to East Rock. Furthermore, Mangrove is East Rock's best investment this year and maybe ever. This has given me and Tourmaline a marquee product placement with East Rock and all of us have benefited tremendously. Likely, there would be no Oskie, Coltrane, Western Standard, Newtyn, Nantahala, Foundation or Valarc without them.

### **Do I recommend stocks or investments to any of our employees?**

I understand why many ask what I think about investing and if my advice is sought in investing, real estate, or fitness I am happy to offer whatever advice I can. Since we started Tourmaline, I have only recommended one investment to anyone at Tourmaline. As you are aware I think Evan Wax of Wax Asset Management is one of the most unique investors and funds I have ever come across. I believe an investment like this accomplishes the exact goal for those who are not

experienced investors. He is an excellent manager and because he is an independent investor, it is not as distracting as buying individual stocks which, for many, can be distracting and more risky. I recommended Larry and Brett look at this as an investment similar to many of you who have asked me.

I ask all of you-Do I recommend investments to you excluding Wax? I think not. I learned my lesson long ago that everyone has a different risk tolerance, time horizon and personal traits that make it challenging to give stock advice. As several of you know, I recommended Hy-drive to too many and they all lost on money. I have not given individual stock advice since then and that was roughly ten years ago.

### **What is my point?**

Optically, I totally understand the oddity and concern of seeing three people in the same firm buying an extremely random unknown pink sheet stock that we have also had a client transact. Certainly an explanation is warranted and helpful in understanding the situation more clearly. I understand concerns that on some days AEYE stock moves 10% to 25% but keep in mind the bid offer spread can be \$0.02 cents or more. This does not seem like much but if the bid is \$0.12 and the offer is \$0.14 merely buying on the offer side moves the stock 17% and selling on the bid side 14%.

Should I have had another partner other than myself approve Brett's purchases in AEYE since I already had a position? Yes, I think that is logical. Should I have told Brett and Larry not to buy a stock I thought was good enough for me? Perhaps, but that is a tough place to be since I am buying AEYE as a long term investment and nothing more than that. For the most part, I never want others to buy stocks I am trying

to accumulate because as a value investor I always want to buy more at lower prices. Other buyers hold shares up at higher prices prohibiting me from buying at better prices. Furthermore, as an employer I do not want to be viewed as telling employees what stocks to buy and or sell or how to invest their money. I do not and will not tell them how to invest their money in individual stocks. Each individual must evaluate their circumstance and invest in accordance with their investment philosophy.

Based on the way I invest in stocks for the long term I am not mindset of thinking anything illicit was occurring. I am not thinking there is an event or catalyst that prompted my investment decision. I was patient to spend four months buying, waiting for better prices. If the better prices never came, I was content not to buy.

In the end, I think many assumptions were made with very little background information. Granted, based on the facts available further investigation was warranted. This is my attempt to fill in the blanks as I recollect.

### **Should we have a new policy?**

I think Henry's idea of adding a reason for buying or selling makes sense. I do not believe it has to be overly complicated, but we could have a checklist consisting of some selections such as: long term investment, add on weakness, suggested by advisor, and so forth. I believe that greater explanation can be requested if necessary or more clarity is required.

I also recommend we should extend our holding period to at least three months. I do not believe that would alter anyone's investment style but optically I think it sounds better to clients who ask about the policy.

Thank you for taking the time to read this. I am happy discuss anything involved in this document further.

Ike

symbol	initial purchase	most recent purchase	years held
dis	8/1/2002	7/16/2002	14
bwxt	6/8/2004	8/13/2008	12
rgrnf	3/30/2006	3/30/2006	10
cvg	12/28/2007	1/25/2008	9
cbm	5/9/2008	5/9/2008	8
mrk	4/1/2008	3/26/2008	8
goog / googl	2/26/2008	2/26/2008	8
lbtya, lbtyk, lila, lilak	7/8/2008	7/8/2008	8
lyb	5/3/2010	9/1/2010	6
aapl	7/25/2012	1/15/2013	4
mdr	10/17/2014	1/14/2015	2
ctrp	7/18/2014	12/5/2014	2
cld	3/10/2015	12/4/2015	1.5
lng	12/23/2015	2/4/2016	1
** indicates stock splits			