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Nuvilex, Inc. (NVLX - OTCQB)

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Deceptive Numbers, Part II

In last week's edition, we referenced how deceptive numbers can be. Little did we know how relevant the topic of questionable accounting would be just a few days later. Late last week, Groupon, the someday-to-be-public "deal-of-the-day" website that offers discounted gift certificates for featured products and services, was forced to restate its revenue (meaning reduce) by over 50% when the SEC commented that its method of booking revenue was, well, flawed. On second thought, a restatement/reduction by more than 50% is more than flawed.

I rarely call out companies for issues like this. Perhaps I should more often. Here is what happened. When the Company filed its original registration statement in June 2011, the financials reflected revenue growth from $30.5 million in 2009 to $713.4 million in 2010, and $664.7 million in the first quarter of 2011.

Unbelievable. Crack-smoking, right?

To be candid, I really did not pay much attention to the filing or news of it when it occurred. I have now and I am pissed.

Apparently, when Groupon would sell a gift certificate, it would book the entire amount as revenue, including what was sent to the owner, rather than just the commission itself. After the regulators at the SEC scrutinized this method, Groupon has now restated the previous figures to reflect the commission, rather than the total value of the gift certificate.

As a result, the 2010 revenue figure is now officially $312.9, rather than $713.4, a 56% decline.

I am not a CPA, nor have I been a CFO of a publicly traded firm. However, this move by management took cojones. Groupon is a really cool middleman but it makes nothing. It is a distributor or broker, if you will.

Therefore, the revenue it booked should always have been the commission, not the stated total value of the transaction.

How obvious can you get? After all, considering the huge decline in revenue due to the restatement illustrates this. Since they produce nothing and provide a service, it begs the question: Why did it take the SEC to open management's eyes?

Let's be clear. I am not claiming the Company committed fraud, or attempted to deceive anyone. This was the accounting method they used, auditors signed off on it. Perfectly legal. But is it right?

No, I say. Statistics and absolute figures are presented in manipulated form all the time. But if the sales growth is so incredible what is the need to, in effect double it? Clearly this growth would provide a high valuation.

I guess management and the board felt that by utilizing the perfectly satisfactory (though now proven incorrect) accounting method, it would help justify the huge losses and a real, crack-smoking valuation.

Here's what I don't get. We have seen this before. At least I have. And I am not speaking of the Enrons, Tycos, etc. of the world. No, I am talking about an obscure penny stock from the late 1980's/early 1990's, called Action Staffing, Inc. It was an employee leasing company which saw revenue rise from $25 million to over $200 million in 4 years. At its peak, I believe that the Company had over 11,000 "employees."

This was not the type of staffing company like the one owned by Baltimore Ravens owner Steve Bisciotti.

Action Staffing routinely made top lists, in major magazines like Inc., as one of the fastest growing firms in the country. However, the revenue was in fact the salaries of the employees, rather than the commissions made on these leased employees.

Sound familiar?

Action Staffing eventually went bust because of losses, and tax and other fraud purveyed by its founder.

I am not saying that Groupon will follow in these footsteps or that anyone in management has done anything wrong.

But this whole mess is such a shame because all of this was so unnecessary. It is growing like a weed, has millions of fans, etc. But, a black mark like this leaves a bad taste in investors' mouths and bad memories full of complete distrust in leading companies.

Who knows when Groupon goes public, the valuation it will be afforded, and how it will be received. I suspect they shot themselves in the foot, and overreached instead of being prudent.

For all of us, let it be a lesson. If it seems too good to be true (revenue growth for example,) it probably is.

Better Than Advertised

It has been a while since we have written on Nuvilex, Inc. (NVLX – OTCQB.) The stock has for the most part, been solid. As it has hung around the $0.05 range for the past few months while the market has dropped substantially.

What prompted our latest report, was further due diligence on SG Austria, ahead of the closing of its acquisition by Nuvilex.

As noted in the report, SG Austria is better than advertised and we reiterate our Speculative Buy rating and $0.50 price target. Here are some highlights:

The deal should close in October 2011. Once it closes, we expect the stock to move substantially higher.

Nuvilex has been transformed from a cult-stock with a quirky history to an emerging, broad-based, multi-functional, therapeutic enhancement platform. Think back to the BASF commercials from the late 1990's. "We don't make….we make everything better." In essence, that is what Nuvilex has with the live-cell encapsulation technology/delivery platform being acquired as part of the SG Austria transaction.

The broad applications for the Company's technology include treatment of multiple cancers, enhanced stem cell implementation, and the treatment of life-threatening viral infections. Additional applications under development provide even more shots on goal for this innovative delivery system pioneer.

The combined firms have leveraged their technologies to execute a total of at least five clinical and preclinical trials.

Now that we have had an opportunity to perform due diligence, we believe that Nuvilex is worth $0.20 today just on the oncology, stem cells and anti-viral therapies alone, and $0.25 for the total company.

May the market treat you well this last week of September.

Until next week….

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Rob Goldman has over 20 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell-side analyst, Rob was a senior member of Piper Jaffray's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*.

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