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2015: Year of the Drone

The word “drone” can conjure up some pretty intense emotions.

For many, the word is synonymous with MQ-9 Reapers dropping bombs overseas (often killing civilians) or even domestic police drones snooping around our own backyards.

Not surprisingly, over a third of Americans worry their privacy will suffer from drone use in the U.S., according to a recent Associated Press-National Constitution Center poll.

In many ways, this fear and distrust of drones is warranted, but as a blanketed statement, it most certainly is not.

Drones, like any other piece of technology, are just tools. They can be used for evil, but they can also be used for good.

So far, most of the public attention toward drones has been in the former context, but starting this year, that’s all going to change.

Despite what you may see on the news, drones can actually be quite friendly. In a recent study, the Association for Unmanned Vehicle Systems International (AUVSI) estimated that drones would add 100,000 new jobs and $82 billion in additional economic activity between 2015 and 2025.

Why 2015? Because that’s when the Federal Aviation Administration (FAA) is mandated by Congress to open the National Airspace System to commercial drones (this could happen as soon as September 30th).

According to the AUVSI:

“Unmanned aerial systems (UAS/drones) in agriculture have the potential to be a $3 billion market in just the first three years after the FAA opens the commercial
airspace. Over the next decade, this number will rise to almost $30 billion.”

![Projected Drone Sales by Unit (Credit: AUVSI)](image)

Teal Group offers even larger projections for the drone market as a whole, predicting $89 billion in sales in the next 10 years, according to its World Unmanned Aerial Vehicle Systems, Market Profile and Forecast.

Further, the FAA predicts as many as 30,000 drones will hit American skies as soon as 2020 — an estimate that’s likely to prove conservative in due time.

And to top it all off, we’re seeing huge investments coming from major tech companies like Google (NASDAQ: GOOG), Facebook (NASDAQ: FB), and Amazon (NASDAQ: AMZN).

Amazon was the first to show interest when it revealed it was testing drones for a potential drone-delivery service called Prime Air. The story was picked up by countless media outlets and even earned CEO Jeff Bezos a slot on “60 Minutes.”

Facebook then dropped $20 million on UK-based drone company Ascenta in March 2014, and Google purchased drone maker Titan Aerospace for $60 million in April.

No doubt 2015 will be a pivotal year for drones. Revenues won’t truly begin rolling in until the fourth quarter, but we want to get in early when stocks are still cheap — not after profits are realized by the rest of the market.
From all Angles

In line with our usual strategy, we’re going to be attacking all facets of the drone industry. That is, companies manufacturing drones, companies manufacturing their components, and companies managing the infrastructure.

Essentially we want to diversify our holdings as much as possible here and create a miniature “drone index” to cover the industry from all feasible angles.

Our primary focus will be in the following areas:

1) Semiconductors

For drones to work effectively, they will need a wide range of internal components. This includes MEMS sensors (accelerometers, gyroscopes, magnetometers, and often pressure sensors), GPS modules, powerful processors, and a range of digital radios. Together, these components tell a drone where to go, how to orient itself, and how to avoid collisions (among other things).

A major upside of investing in these companies is that many of the components are either already being used in today’s smartphones or have further applications outside of drone use (particularly in robotics). Even if the drone industry is slow to take off, these companies are diversified enough to diminish any significant risk.

2) Imaging

As we mentioned earlier, the agricultural drone market is poised to hit $3 billion within three years after the FAA opens the commercial airspace. In 10 years, the figure is expected to hit $30 billion.

Extensive consolidation of farmland has led to massive fields that cannot be traversed by land in a timely manner. Instead, farmers now need to view their land from the sky.

This point of view can be obtained with satellite imaging, planes, or helicopters. However, these methods provide low-resolution images and/or are very expensive. Autonomous imaging drones offer a better service at a cheaper price, which is exactly why the AUVSI expects precision agriculture to see substantial growth in the next two decades.
Autonomous farm drones can take off, fly, and even land without human assistance. These drones are used to survey large farms to increase efficiency and productivity in several ways.

Drones will allow farmers to spot disease and general problems with their crops faster than with satellite or conventional aerial imaging. These drones can be deployed on site daily due to their small size and, more importantly, low expense.

Second only to physical control/navigation, imaging systems will be crucial for this form of surveillance. The more detail, the better.

3) Manufacturing

Last, but certainly not least, are the actual drone manufacturers themselves. We’re not talking about military drone makers, though — we’re looking at pure plays that are going to benefit from incoming commercial regulation.

Before we go on, it’s worth noting that this is a category you need to be especially careful with. Because pure plays are so scarce, many investors already know about them. Likewise, these are the most obvious investments in the drone industry.

The danger with this is that hype can easily inflate the price of these stocks. It’s important to avoid purchasing at inflated prices (even if the company does have a promising future ahead of it).
For this month’s issue, we have two recommendations: one sensor play and one imaging play. Keep an eye out over the next few months for a drone manufacturer as well as additional companies in the former categories.

**Intel (NASDAQ: INTC): A Sensor Play**

Intel kicked off the International Consumer Electronics Show (CES) off with a bang during its keynote this year.

The company revealed a highly diversified lineup of products and innovations, the most notable being its RealSense technology.

RealSense uses 3D cameras that perceive depth and motion and relays that information to relevant software. Applications for RealSense range from 3D scanning to gesture control to holographic “*Minority Report*-style” interfaces.

But the most eye-catching display from Intel was a demonstration of how RealSense can be used to create collision avoidance for drones. In partnership with private drone manufacturer Ascending Technologies, Intel showed off what are essentially self-flying drones, capable of navigating from point A to point B while avoiding obstacles.

Demonstrators even played a game of “drone-pong,” using their bodies to push a drone back and forth as it continuously avoided crashing into them.

For all intents and purposes, these drones can “see” the world around them, interpret it in three dimensions, and respond accordingly.
This is ultimately the kind of technology that will separate commercial drones from recreational ones. It will allow companies to release drones out into the open world without endangering the people or property around them (fingers crossed).

To be clear, Intel has no plans (that we know of) to market its own drones. Instead, the company is focused simply on empowering them from within. This is the role Intel has taken with PCs, and it’s the role it will continue to excel at as time moves forward.

**Behind the Curtain**

Of course, you don’t buy Intel just because it’s setting itself up as a component provider for drone OEMs.

Instead, you buy the company because it’s proven itself capable of adapting to changing trends time and time again.

Intel has long been the epitome of its “Look Inside” slogan, having developed a diversified line of verticals across PCs, tablets, and mobile phones. The key to Intel’s success is not in a particular chip, but rather in its ability to diversify across multiple consumer electronic segments.

Over the next decade, there will be three primary new trends in consumer tech: wearables, the Internet of Things, and drones. Intel is attacking each one just as it has done with PCs, laptops, and mobile devices.

Expect the company to continue its semiconductor dominance for the foreseeable future.

**Financial Picture and Recommendation**

As has been the case for quite some time, Intel’s financial picture is very strong.

Quarterly revenue growth sits at a solid 8%, which is rather impressive for a $176.5 billion company.

Net income was $10.7 billion in the most recent quarter, representing 12% growth on the bottom line. Again, quite impressive for a company of this size.

Operating margins were robust at 26.9%. Profit margins were as well at 19.4%. Compared to rival AMD, Intel is the clear winner here. The former barely squeaked by last quarter with a
A profit margin of just 0.85%.

As for Intel’s balance sheet, the company has $13.0 billion in debt and $15 billion in cash on hand. It has the flexibility to leverage cash for growth while also being able to pay off its debt (with $2 billion left over).

And when it comes to value, Intel is one of the most enticing companies in the tech industry. It boasts a PE of 17.4 compared to the industry average of 41.42.

For further perspective, there is only one broad-line semiconductor company (out of 27) trading at a lower price to earnings.

We’re buying Intel Corporation (NASDAQ: INTC) below $38 with stop-losses set at $34. Shares trade at $36.35 as I write.
Ambarella (NASDAQ: AMBA): An Imaging Play

OK, I know what you’re thinking: How is GoPro not the imaging play for drones? After all, the company is developing a line of multi-rotor drones equipped with its widely popular high-definition cameras, right?

Yup, that’s true. And GoPro would be a great stock to own — if only it weren’t trading at 185 times earnings. But alas, GoPro is still one of the most overhyped stocks on the market, even after losing nearly half its valuation since late September.

So how do you get in on drone imaging without owning shares of GoPro? Well, you buy the company supplying it.

Ambarella is the exclusive supplier of GoPro’s system-on-a-chip technology.

The chip enables the cameras to record 4K ultra HD video up to 30 frames per second (or 1080p at 120 fps) at a fraction of the power and storage of rival chipmakers. A product brief can be found here. http://www.ambarella.com/uploads/docs/A9%20Product%20Brief%2020120813-2.pdf

Without Ambarella, GoPro wouldn’t even exist. The latter company is best viewed as a brand. The former is a provider of essential technology...

Not Just Drones

Don’t be mistaken, though; GoPro is not Ambarella’s only customer. In fact, the camera company accounts for just 25% to 30% of Ambarella’s total revenue.

The company boasts a diverse product line, including:

- Low-power wearable cameras (perfect for police cams)
- Sports cameras
- Video security and surveillance solutions
- Semiconductors for video broadcasting
While Ambarella will benefit from GoPro’s growth, it’s certainly not reliant on it. The remaining three-quarters of the company’s business have helped provide it with some of the strongest fundamentals in the industry.

Here are a few key metrics worth noting:

First, revenue growth is incredibly strong at 42.8% quarter over quarter. Ambarella posted $65.7 million on the top line in the third quarter of 2014 compared to $45.9 million in the same period a year prior.

The company also posted $18 million in income during the same period. The figure represents a doubling of Ambarella’s bottom line in 2013.

Additionally, profit margins for AMBA were at a solid 19.86%. Compare this to competitor Fujitsu Limited’s (OTC: FJTSY) 3%, and you start to see the value here.

Cash position is also very healthy, with zero debt and a $193.5 million safety net. Nothing to complain about here.

Adding to the bull case even further, the short float for AMBA is a whopping 30.9% right now. The stock has had positive momentum since August, and those positions will need to be covered at some point.

**We’re buying Ambarella, Inc. (NASDAQ: AMBA) under $65 with stop-losses at $45.00. Shares trade at $57.95 as I write.**
Portfolio Snapshot and Updates

Alliance Fiber Optics (NASDAQ: AFOP)

*Snapshot:*

Alliance Fiber Optics provides a broad range of fiber-optic components and modules essential to the communications industry.

Fiber optics are hair-thin wires made of glass or plastic that send digital information by transmitting light signals. These fibers are bundled together to form miles of optical cables. The majority of AFOP’s revenue comes from fiber-optic connectors used to link these strands of fiber together.

*Updates:*

No new updates this issue.

Anika Therapeutics (NASDAQ: ANIK)

*Snapshot:*

Anika develops products for tissue protection, healing, and repair. The company’s products are based on a naturally occurring polymer called hyaluronic acid (HA). Our bodies use HA to enhance joint function, protect soft tissues, and support skin elasticity.

Anika’s viscosupplementation products are used to treat osteoarthritis, correct facial wrinkles, aid in ocular surgery, and prevent post-operative internal adhesions. Anika receives marketing support from major drug manufacturer Johnson & Johnson (NYSE: JNJ).

*Updates:*

No company news for Anika this issue, but in light of weak price action, we’re going to sell half of our position to protect our current gains.

**Sell 50% of Anika Therapeutics (NASDAQ: ANIK) for a 69% gain.**

Corning Inc. (NYSE: GLW)

*Snapshot:*

Corning Inc. manufactures high-quality ceramic and glass material for consumer and industrial applications. The company is best known for its incredibly durable Gorilla Glass, commonly found in consumer devices such as smartphones and tablets.

*Updates:*

Corning hit a new five-year high to kick-start 2015. We’re expecting a breakout this year, as the
company has several major catalysts on the horizon.

At the Consumer Electronics Show (CES) earlier this month, Corning revealed its new Iris (TM) Glass, a substrate that can “significantly reduce” the thickness of LCD televisions.

Iris Glass is 36 times stiffer than plastic and delivers 90% lower thermal expansion. This ultimately allows OEMs to build televisions that are less than 10mm thick (about the same as a smartphone), according to a company press release.

Jointly, Corning has upgraded its LCD glass volume projections for the current quarter, moving from flat expectations to single-digit growth. The updated expectations can be partially attributed to last month’s announcement that Samsung will be using Gorilla Glass 4 in its next-gen Galaxy Alpha smartphone.

And on December 15, Corning announced the acquisition of TR Manufacturing, a provider of fiber-optic assemblies that will now fall under Corning’s Optical Communications segment.

The first two pieces of information here are clearly bullish for Corning. Television OEMs will flock to Corning for Iris Glass (the race for thinness is ongoing), and increased volume projections are always welcome, as they indicate growing demand.

The benefits of purchasing TR Manufacturing, however, are a bit less clear. TR’s machining capabilities certainly hint at expansion of Corning’s Optical Communications segments, but the company hasn’t released any figures on the cost of the acquisition. There’s not much we can conclude from the acquisition at this point.

Lastly, we saw some traction for GLW’s antimicrobial touchscreen glass, which was revealed at CES last year. ATM maker Diebold (NYSE: DBD) and point-of-sale company Clover have both announced they will be using the glass in their latest devices. This should be a nice bump for Corning so long as other point-of-sale providers follow suit.

Fanuc Corporation (OTC: FANUY)

Snapshot:

Fanuc Corporation is a leader in industrial robotics, with a product lineup that includes factory automation systems, laser cutting, motion control, and compact motors. Fanuc serves a wide range of industries including aerospace, agriculture, construction, metal forming, and automotive manufacturing.

Updates:

No new updates this issue.
Foundation Medicine, Inc. (NASDAQ: FMI)

*Snapshot:*

FMI uses DNA sequencers to generate genomic and molecular data used to inform pharmaceutical companies in drug development and physicians in clinical practice, specifically in regards to cancer research and treatment.

Foundation’s leading products are the FoundationOne and FoundationOne Heme genomic platforms. These platforms provide advanced sequencing that matches DNA mutations within a tumor to targeted therapies either on the market or in development. By identifying these mutations and matching them with available therapies, FMI enables researchers and clinicians to pick the best option for defeating cancer.

*Updates:*

No new updates this issue.

InTEST Corp. (NASDAQ: INTT)

*Snapshot:*

INTT is a semiconductor capital equipment company, which means it manufactures machines used in the production of electronic components.

The semiconductor capital equipment industry can be divided into two classes: front-end and back-end. The front-end involves silicon wafer and computer chip fabrication. The back-end involves assembly, packaging, and testing.

InTEST works on the back-end of this cycle, providing automatic test equipment (ATE) used by semiconductor manufacturers to test their integrated circuits and wafer products.

*Updates:*

No new updates this issue.

Iridium Communications Inc. (NASDAQ: IRDM)

*Snapshot:*

Iridium is a global communications provider. The company offers the world’s most extensive voice and data service through a fleet of next-generation low-orbit satellites.

*Updates:*

Iridium announced a successful completion of its first testing phase for the Iridium NEXT platform software, which will manage all flight functions on the company’s new satellites. The
first stage of testing included all the primary functions: power management, positioning of solar arrays, navigation, altitude control, and propulsion.

Preparation for the NEXT satellite system continues to move along smoothly for Iridium. We’ve seen no hiccups so far and are on schedule for the first launch in 2015.

**iRobot Corporation (NASDAQ: IRBT)**

*Snapshot:*

iRobot is an American robotics company that serves the consumer, medical, enterprise, and military industries. iRobot’s product functions range from home cleaning to telecommunication to various military operations. iRobot currently generates the vast majority of its revenue from its Home Robotics division.

*Updates:*

No new updates this issue.

**Monster Worldwide (NASDAQ: MWW)**

*Snapshot:*

Monster Worldwide is best known for its domain Monster.com, one of the most visited employment websites in the United States and one of the largest in the world. The company earns the bulk of its revenue by selling a space for employers to post jobs. Standard job ads cost between $210 and $395 per post, and skilled and hourly job ads start at $119. Monster also charges employers to search through its resume database for talent acquisition.

*Updates:*

No new updates this issue.

**Oceaneering International, Inc. (NYSE: OII)**

*Snapshot:*

Oceaneering International provides engineering services and hardware primarily to customers operating in marine environments. The company’s services are marketed to oil and gas companies as well as the aerospace and construction industries. The company receives the bulk of its revenue from ROVs and Subsea Products.

*Updates:*

No new updates this issue.
OPKO Health, Inc. (NYSE: OPK)

**Snapshot:**
OPKO Health is a mid-stage biotechnology development and medical diagnostics company. OPK has a deep drug candidate pipeline spanning from kidney disease to cancer treatments. It also provides a revolutionary diagnostic test known as the 4Kscore, used in prostate cancer screening. The company’s proprietary diagnostic technologies allow doctors to keep blood-based tests in house rather than outsourcing to outside laboratories.

**Updates:**
It was only a matter of time before OPK saw some interest from Big Pharma. As of December 15, the company is partnering with Pfizer, the largest pharmaceutical company in the U.S.

The deal is for OPK’s growth hormone product, Lagova hGH-CTP. The drug targets growth hormone deficiency in adults and children, and it also treats growth failure in children.

OPK will receive $295 million up front and up to $275 million in future milestone payments. For perspective on how huge this deal is, consider that the initial payment alone represents three times OPK’s revenue in 2013... and this is just one product in OPK’s highly diversified portfolio.

Shares hit a one-year high and should continue to rally as OPK gets more press. Buckle up, folks.

Universal Display Corp. (NASDAQ: OLED)

Universal Display provides materials and licensing for a new form of electronic display known as organic light-emitting diode (OLED), which is thinner, lighter, and more responsive than traditional displays. OLED displays also offer better visual properties such as higher contrast ratios and increased viewing angles.

**Updates:**
No new updates this issue.

Vivint Solar, Inc. (NASDAQ: VSLR)

**Snapshot:**
Vivint installs residential solar systems for customers through long-term (20-year) contracts at relatively lower rates than their average utility bills. Unlike SolarCity, which expands to business and government customers, Vivint is solely focused on the residential market. The company uses old-fashioned door-to-door tactics for sales.
Updates:

No company news this issue, but we see a bottom forming at the $8 mark. **We’re buying back into Vivint Solar, Inc. (NASDAQ: VSLR) under $10.00. Stop-losses are at $7.50.**