Rubicon Technology – A Promising Net-Net Cash-Box Situation

by Isaac Dimitrovsky, July 18, 2018

- Rubicon is trading well below likely liquidation value, with most of that value now in cash and short-term investments.
- The company is what's left of a flameout in the formerly hot sapphire sector, but is selling assets and has drastically cut back on operations and cash burn.
- The CEO as of March 2017 is Timothy Brog, who has a track record suggesting he'll do a good job of reallocating their cash.
- The company has made good progress in the past year and appears less risky than when Brog took charge, but the stock price hasn't responded yet.
- There's possible additional upside from large historical operating losses if a properly structured deal can be done.

This note is an update on a company most recently profiled here by Seeking Alpha luminary Antao, in an informative and convincing article from March 2017. Interestingly, in the year and change since that article appeared, Rubicon has made decent progress on several fronts, but the stock can still be had for about the same price. I therefore thought it was well worth an update at this time.

A little history not that relevant to the current situation but included for completeness: Rubicon is the wreckage of a formerly hot stock in the formerly hot-hot-hot sector of lab-grown sapphire crystals. The hype-and-crash cycle can be followed fairly well on Rubicon's long-term stock chart; after trading as high as $300 a share (reverse-split-adjusted) in the 2008-2011 period, it crashed to around $100 through mid-2014, then suffered a further 90%+ decline to present levels. The company's historical fortunes are also reflected in the “accumulated deficit” entry on their balance sheet, which as of the most recent 10Q had ballooned to an accumulated loss of $330M. (Some of you may recall the even more spectacular flameout of GT Advanced Technologies, another company in this sector – it was selected by Apple to supply sapphire screens for iPhones, but eventually collapsed all the way into bankruptcy amid a storm of charges and counter-charges).

At the time Antao's article appeared (March 30, 2017), Rubicon had finally accepted defeat and made the decision to exit the great majority of their sapphire business, retaining just the relatively small and high-margin optical/industrial segment. They were therefore planning to liquidate most of their production-related assets. They had also just hired Timothy Brog, an activist investor who had tackled a pretty similar cash-box situation when he became CEO of

Peerless Systems in 2010 with the stock price below $3 a share and sold it to LCV Capital for $7 a share in 2015.

Rubicon's stock responded quite favorably to the announcement of Brog's hiring as CEO on March 16, 2017, popping from below $6 a share right before the announcement to over $8 in the following two weeks. However, the stock price has languished at around that level in the year and change since, even though the company has made some good progress in that time and now appears significantly less risky than when Brog took charge:

- Cash burn has been reduced dramatically. It's hard to calculate exactly what it's likely to be on an ongoing basis, but by my reading of recent 10Q's it's down from relatively hair-raising levels when Brog took charge to a few hundred K per quarter and falling.
- A big chunk of production-related assets has successfully been sold, reducing the risk of asset writedowns. As of their latest 10Q reporting for March 31, 2018, Rubicon shows $34.028M in current assets, of which $18.84M are cash and short-term investments and $11.08M are assets held for sale, against $1.26M in liabilities. With 2.74M shares outstanding, Rubicon has almost $12 a share in current assets net of liabilities, of which almost $7 is cash and short-term investments. Even a large haircut to the remaining assets for sale would still leave a substantial excess over the current stock price of around $8/share.

Barring outright fraud, the two main ways to lose money on a situation like this are:

- The cash is eaten away by operating losses (the melting ice cube scenario).
- Management blows the cash on something dumb.

As mentioned above, cash burn has been drastically slowed, giving some reassurance on the first front. I think the second is really the crux of the investment decision here. On this front, as noted in Antao's article, the hiring of Brog as CEO seems like a good sign based on his track record. Brog's early record as an activist value investor is promising enough, but his experience as CEO of Peerless Systems is what really stands out, since as mentioned it was a pretty similar situation.

Like Rubicon, when Brog took charge Peerless was a company that had sold off most of its historical business and was left with a large cash pile to reallocate. Moreover, while things eventually worked out well, Brog did suffer a couple of setbacks at Peerless. He invested in a cash-rich but poorly run company called Moduslink that appeared to be a promising turnaround play, but lost a proxy fight to another company that then proceeded to run Moduslink into the ground. I believe he also had a plan to use Peerless as a platform to create a closed-end fund to do activist value investing, but was unable to get the required approvals. Rather than get frustrated and do something dumb, Brog had the patience to cut his losses on Moduslink, wait out a relatively frothy market, and finally in late 2014 buy Deer Valley Corp. at a bargain price. I believe this bargain purchase was from a hedge fund that was winding down and therefore may have been anxious to liquidate. This deal then set the stage for LCV Capital's buyout of Peerless a few months later.

All in all, the Peerless episode therefore gives me some comfort that Brog is a good person for the Rubicon job.

Another mildly positive factor is that an activist fund called Bandera Partners has taken a 15% position in Rubicon and now has a representative on the board (Jefferson Gramm). This could provide another active shareholder-friendly voice if and when the board considers significant actions.

Finally, there is a possible hidden kicker from Rubicon's aforementioned large historical losses. With a properly structured deal in which Rubicon acquires a profitable company these past losses could be worth a substantial amount in taxes avoided, though I haven't assigned any value to them here.

Catalysts:

- Brog finds a good way to allocate the company's cash. This could happen any time, but most likely will take some time and patience.
- A deal is found that gets some value from the past operating losses.
- Liquidation of the remaining assets held for sale.

Risks:

- Brog could invest the company's cash in something dumb, though he has a good track record of doing otherwise.
- The remaining assets held for sale could wind up being unsaleable.