



5 Ways to Pick Penny Stocks

Being an investor that focuses on penny stocks is similar in certain ways to being an angel investor. You're investing in start-ups, which means you're looking for a great story. And you're looking to find something special, a destined winner amid a noisy sea of mostly ill-fated ventures.

Good penny stocks are definitely out there, but the penny stock markets as a whole are more treacherous than traditional markets. Penny stock prices are more easily manipulated. As an investor, you have to stay vigilant against pump-and-dump scammers, false gurus, and other hucksters.

If you can stay focused, learn the ropes, and avoid the pitfalls, then you may just find the next big penny stock success story. The following tip list was created to help investors find good penny stocks to buy in 2017.

Best Practice #1: Pay Close Attention To Debt

With higher interest rates on the horizon for 2017, the price of capital will be even more expensive, and debt-laden companies looking to refinance won't find an abundance of options.

In many cases, the primary reason a stock is priced low enough to be considered a penny stock is because the issuing company has amassed a boatload of debt.

Heavy debt will not only sink a company's stock price, but it will also slow its earnings potential and increase the likelihood that the company will file for Chapter 11 bankruptcy.

Looking closely at the debt picture will not only allow you to weed out companies with unmanageable debt, it will also allow you to discover the companies on the other end of the spectrum. These the ones that are in a strong position, capable of servicing their debts and growing their business!

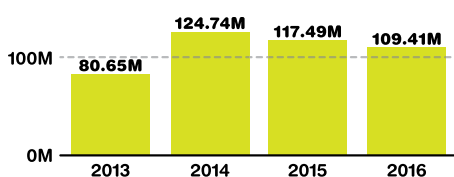
AROTECH (ARTX)

A company's debt ratio is calculated by dividing its total assets by its liabilities. Here, we can see that ARTX is on the rise in each of the three key categories of assets, liabilities, and equity.

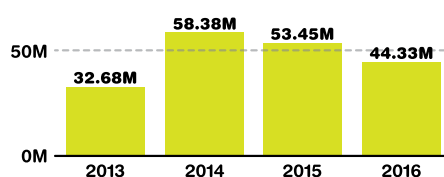
This penny stock was recently recommended by PersonalIncome.org as a top 2017 penny stock to watch. If we look at the company's debt ratio over the last three years, we'll notice that it has gradually decreased, meaning that the company is proving its ability to handle the debt it accumulates.

ARTX's 2016 debt ratio (40.5%) is less than its 2015 debt ratio (45.5%), which in turn is less than its 2014 debt ratio (46.8%).

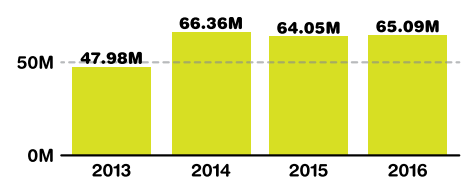
Total Assets



Total Liabilities



Total Equity



ARTX has reduced its debt consistently, and especially so during 2016. It's no wonder that the stock's been able to return close to 20% over the last twelve months and 150% over the last five years.

To sweeten the pot for a cautious investor: ARTX isn't a Pink Sheet stock but is traded on the NASDAQ, so we can better rely on the accuracy of the company's financial reporting.

Best Practice #2: Don't Discount Your Gut

If you're shopping for stocks to buy in the penny stock market, then you should already be locked and loaded with a first-rate BS detector. When combined with basic financial literacy, your gut instincts can contribute much to your fundamental analysis of a stock. A company destined to survive and thrive is a company that aggressively delivers value to consumers every chance it gets.

When you visit a company's website, it should be making the most of its web-based interaction opportunity. This includes offering to add the customer to a mailing list for special promotions, making its menu easily accessible, and giving customers the ability to quickly locate ecommerce sites as well as any brick-and-mortar retail locations (if applicable).

This "visit a company's website to see if it's a good investment" approach may seem a bit over-simplistic. But then again, this is the face the company is choosing to show the world. Take good note of it.

Here are some questions you should be asking:

- Does the business's story make sense?
- Will the market respond favorably to the product or service being offered?
- Is the business defensible? Have the necessary patents been filed to prevent larger competitors from muscling the smaller company out of business?
- Is the company's leadership qualified? Do executives have a good track record in relevant industries?
- Do the company's claims and rhetoric match its financial data? Is the leadership grounded and clearheaded, in touch with reality?

And the real question:

- **Do they have a real plan or do they just want your capital?**

Contrast and corroborate your gut instincts with what's being said about the company in the financial news media—they've no shortage of opinions. Many stock-tracking apps, including the iPhone's pre-installed Apple stocks, will automatically link relevant financial news to any stocks you follow.

Best Practice #3: Find Favorable Liquidity Ratios

Liquidity ratios measure how a company's more liquid assets (like cash) and marketable securities stack up against its liabilities (debts). There are several ratios used to measure liquidity, including the cash ratio, operating cash flow ratio, quick ratio, and current ratio.

The current ratio, for instance, measures total assets over total liabilities (a simple inversion of the debt ratio).

The cash ratio measures only cash on hand (plus marketable securities) over total liabilities.

The operating cash flow ratio, which some consider to be the most important liquidity ratio for penny stocks, measures only incoming cash generated by a company's operations. If the operating cash flow ratio, for instance, is 50% or lower, it means that the company has twice as much in the way of liabilities as it has cash on hand.

Whether or not a 50% operating cash flow ratio is a problem for a company depends on the nature of the business and the structure of its obligations.

Generally, however, liquidity ratios of 50% or lower are cause for concern and should be investigated further before purchasing the stock.

Almost all liabilities must be serviced by cash.

You generally can't use a non-liquid asset to pay your bills. This means if a company is regularly having a hard time generating enough cash to service its liabilities, then it may not survive.

$$\text{Current Ratio} = \frac{\text{Total Assets}}{\text{Total Liabilities}}$$

$$\text{Cash Ratio} = \frac{\text{Cash Assets}}{\text{Total Liabilities}}$$

$$\text{Operating Cash Flow Ratio} = \frac{\text{Incoming Cash from Operations}}{\text{Current Liabilities}}$$

Best Practice #4: Listen To The Stories Told By The Numbers

Piggybacking on Best Practice #3, let's take a look at a "red hot" 2017 penny stock pick.

CORDOBA MINERALS CORPORATION (CDBMF)

CDBMF trades on one of the better-regulated OTC markets (OTCQX) and until recently was barely a blip on the radar for most investors.

Cordoba really took off in 2016, when it returned 465.88% back to investors. That's a huge return.

But if we look at the company's financial reporting from 2015, a year when it posted a big loss and shares were selling for roughly 10 cents (compared to today's much more respectable price of \$1.36 at time of publication) we'd notice a huge gap between the cash ratio and the operating cash flow ratio.

While CDBMF's 2015 operating cash flow ratio was negative (-8.63 to be exact) owing to the fact that the company lost money, the cash ratio was actually a very respectable 2.24. Why?

Well, there's really only one explanation when you think about it—the company had deep pockets. People were invested in the company and expected big things out of it, and, in 2016, CDBMF delivered. A combination of factors, including the launch of a new mining venture in Colombia and the stock's move to the OTCQX in the United States, have surely played a role in this Canadian success story.

In a story like this one, the 2015 measures of CDBMF's operating cash flow ratio acted as a measure of the company's immediate success (dismal). On the other hand, its cash flow ratio acted as a measure of investor confidence in the company's future success (strong). To be wise investors we must let the numbers speak and point us in the right direction.

If we think we have a significant amount of investor confidence, for instance, but poor cash flow, we might want to drill down on investor profiles. This means getting as much information as we can about our stock prospect's current investors. Many websites like GuruFocus.com give everyday investors opportunities to peek into the portfolios of the Street's heaviest hitters.

Best Practice #5: Use A Stock Screener

As we saw in our previous example, relying too much on any particular stock metric can be problematic. To be a successful investor, you must instead strive to comprehend the greater story behind the stock.

But there are thousands of stocks out there and you're not going to study them all. You have to find ways to narrow the field. One highly efficient way of sorting stocks and arranging stocks at-large according to specified metrics is through the use of a stock screener. These tools are offered by brokerages and other companies, sometimes for free and sometimes for a price.

Screeners allow investors to filter their view of various stocks. Let's say you want to have a look at penny stocks in the energy sector with price-to-earnings (P/E) ratios of twenty or lower.

Or perhaps you'd like to view only stocks that have returned at least 30% for their investors over the past year. A good screener can help put good penny stocks on your radar. Just remember, especially with penny stocks, that the numbers by themselves can be deceiving. Be sure you're getting the bigger picture.

The Bottom Line

Smart investing is about cutting through the smoke and mirrors to find promise in the market that others may be missing. For the intrepid investor, the vast, unfettered, Wild West of Wall Street that is the penny stock market is sure to deliver a wild ride. And hopefully a lucrative one as well.

Good luck!