# Red Herring

## The perils of penny stocks

Print All Articles Letter to the editor Podcast listen now
on 04 August 2002, 22:00
by staff

It's hard to think of a hotter field at the moment than security technology. In the year since the terrorist attacks of September 11, companies in the screening, surveillance, and crowd control fields have seen their stock prices triple and even quadruple in an investor frenzy to profit from the first big rocket ride of the new millennium.

Not many companies have caught the updraft better than tiny Imagis Technologies of Vancouver, British Columbia (OTC: IGSTF). While the company had fewer than 30 employees at year-end 2001, and last year racked up a mere C$2 million (US$1.3 million) in revenue, its stock price soared nearly tenfold after the attacks, from $0.35 a share to $3.40, lifting its market value from less than $6 million to nearly $60 million in early March. Even with the market downdraft, at press time the stock was trading for $1.40--four times its preattack levels.

Investors are said to be particularly smitten by Imagis's biometric technology--facial-recognition software that digitally stores photographs of known terrorists, then matches them against live human beings at places like police stations and airports. The company claims to have more than 100 installations of its software in such places as police departments across the United States, Royal Canadian Mounted Police offices throughout Canada, and Toronto's Pearson International Airport.

Imagis also has another big plus: for the last two years, the company chairman has been Oliver "Buck" Revell, the one-time head of antiterrorism activities for the Federal Bureau of Investigation. Mr. Revell worked under FBI directors from J. Edgar Hoover to William Sessions, eventually rising to the highest career-official position in the bureau, where he was responsible for all national criminal investigations and antiterrorism activities.

Add it all up, and it's hardly surprising that Imagis has caught the eye of at least one major U.S. company, California-based OSI Systems, a manufacturer of optoelectronic equipment. In July, OSI, which had 2001 revenue of $111 million, invested $1.8 million for about 6 percent of Imagis's stock, with the aim of developing a "strategic partnership."

But anyone who thinks this makes Imagis too good to pass up at its current price of $1.40 a share should consider a primer on the Vancouver penny stock market--and the characters who lurk there. This isn't a market in which value, like cream, rises to the top. It's a world where prices tend to go up because someone is helping them up--and just because a company has someone like Mr. Revell on board hardly makes a stock a safer investment.

In fact, a close look at Imagis suggests that the company has already developed into a plaything for denizens of the penny stock world.

At the center of some of the recent action is a mysterious Boston financier named Treyton Thomas, who issued a carefully worded quasi-buyout offer in the spring that caused a sudden rise in Imagis's stock price. We'll delve more deeply into the story of Mr. Thomas in a minute, but for now it's enough to know that he claims to run a hedge fund that may or may not exist, and that he operates out of a building in Boston where you can rent a desk by the week or even the day. Whether or not these are solid credentials, I can't say, but Imagis recently gave Mr. Thomas a seat on its board, at the elbow of Mr. Revell.

Imagis has a typical background for a Canadian penny stock. The company was incorporated in the spring of 1998 as a "blind pool" fund, in which speculators paid C$0.30 per share for 1.5 million shares of stock, giving the business C$450,000 with which to buy a company of some sort and set itself up in business.

There were five original Imagis shareholders, with one of them--a fellow named Altaf Nazerali--apparently calling the shots. The five appear as founding shareholders in a number of similar deals, most of which are complex financing transactions that seem to end in offshore shell company accounts.

In any case, no sooner did Mr. Nazerali have Imagis up and running the following spring than he invited Mr. Revell, by that time five years into his retirement from the bureau, to join the company as an outside director. Mr. Revell says he had Mr. Nazerali "vetted" before accepting the offer, and that Mr. Nazerali has "never been involved in unethical or illegal activity."

Within a year, Mr. Nazerali had elevated Mr. Revell to the position of chairman, even as new players began to gather in the hope of some action. By year-end 2000, the company had issued more than 985,000 options to insiders, and 200,000 warrants to outside promoters in exchange for their stock-touting services.

But that was nothing compared with what lay ahead. As 2001 unfolded, Imagis began pumping out an absolute avalanche of options, warrants, and unregistered stock. By the end of the year, 6 million shares of such unregistered paper were in the hands of more than 50 unnamed investors. Mr. Revell received options for 100,000 shares.

At that point, the mysterious Mr. Thomas made his appearance. He claims to be the owner and principal of a $600 million offshore hedge fund outfit called the Pembridge Group, and to head a philanthropic foundation bearing his name. So he seemed to be perfumed with the aroma of money when Imagis's CEO, Iain Drummond, and Mr. Revell met him. Both say they "checked him out."

Yet they never asked for or saw an audited (or unaudited) statement of his fund's holdings or performance. They never spoke to a single investor in any of the funds. They never asked for his employment history, a D&B report on his group, or even information on his alleged foundation. They never even visited his office.

Securities industry regulatory filings show that Mr. Thomas enlisted in the U.S. Marine Corps in 1974 at the age of 18 and served as a courier in Rabat, Morocco. Following his discharge in 1977, he attended Virginia Polytechnic Institute.

But gaining career traction wasn't easy for the young man, and after leaving college in 1981 he moved through six jobs before landing a steady position as a broker in the Atlanta office of Merrill Lynch in 1984. He left in 1989, and thereafter worked through six more jobs, including a stint as a private investor with an otherwise unknown Atlanta outfit named Pembroke Holdings, before leaving the securities industry entirely in 1998.

Little else is known, except that in 1997 Mr. Thomas apparently ran afoul of the Internal Revenue Service and was a debtor with at least one tax lien against him. Mr. Thomas maintains that the taxes were paid and the lien was removed.

Mr. Thomas has claimed in a celebratory press release about himself to have launched the Pembridge Group in 1995. But business records at D&B give the date as 1997, and list the organization as a limited liability company located in an Atlanta office that provides desk space and telephone service on a short-term basis.

As for Mr. Thomas's Boston office--well, Mr. Revell and Mr. Drummond only met him, separately, in their hotel rooms at the Ritz-Carlton in Boston. So they never learned that Pembridge's "offices" were, once again, nothing but a few desks and a phone answering service at a company that rents floor space to traveling businesspeople--the same company, in fact, that operates out of the offices where Mr. Thomas was renting space in Atlanta.

Nonetheless, Mr. Revell and Mr. Drummond peeled off another 50,000 warrants at C$2.20 per share to corral Mr. Thomas's "strategic financial advice."

How did Mr. Thomas respond? Scarcely two months after getting his warrants, he issued a press release implying that the Pembridge Group was interested in taking Imagis private at an almost 100 percent markup over the existing market price. This caused the stock to spike immediately, and the value of his warrants spurted as well.

Mr. Thomas did not respond to several requests for an interview on these and related matters. Nor did he respond to a detailed list of questions that he requested be submitted in writing prior to an interview.

Yet Mr. Revell and Mr. Drummond are clearly happy with him. "He's bought up 10 percent of our stock," Mr. Drummond told me proudly, while acknowledging that he didn't actually know for sure whether Mr. Thomas was in fact the owner of the shares. Even so, Imagis offered Mr. Thomas a seat on its board in July, which he accepted.

As for Imagis's actual business--forget it. Whatever the presumed merits of its software, the company's auditors flagged its financials with a "going concern" warning in March, and little has happened since to improve the outlook. Cash and short-term assets have tumbled dramatically since the start of the year, and though revenue is up on new software sales, losses continue to mount.

Is this any way to run a company? On the Vancouver penny stock market, it clearly is, which is something the folks at OSI Systems, having already paid their $1.8 million, may learn for themselves. As for everyone else, save yourself the cost of the lesson and remember: penny stocks don't become attractive investments just because the board has a graybeard chairman with impressive credentials. And if sitting next to him is a man who claims to run a $600 million hedge fund that may or may not even exist, then just smile politely and start backing out of the room.

*Christopher Byron is a syndicated radio commentator and writer living in Connecticut. He is also the author of* Martha Inc.: The Incredible Story of Martha Stewart Living Omnimedia*. Mr. Byron does not invest in equity securities in any form. He holds only U.S. government bonds, notes, and CDs.*

Topics: Stocks, Perils, Penny