

Welcome to Deep Value Letter

I am restarting publication of a quarterly value investing newsletter this year, and would be glad to have you as a subscriber.

I have significantly outperformed the market over many years using a behavioral finance and value methodology, and am providing **a record of audited account statements** from my personal Roth IRA, showing over 400% total return over 7 years compared to 11.3% for the S&P500 average. Past performance does not guarantee future results.

In a previous edition of this newsletter published from 2004-2005, I identified a series of deeply undervalued microcap securities which in many cases resulted in well over 100% returns for investors over several years. I am now making a risk-free trial subscription available to former subscribers and a few other individuals. By subscribing today, you can lock in at a reduced introductory rate and will pay nothing unless you are absolutely satisfied.

Please enjoy the attached complimentary research reports, review my audited performance record, and enter a free trial subscription at no risk to you. If you do not earn more than two times the subscription price through use of the research provided, or are otherwise not totally satisfied for any reason, you can cancel at any time and owe nothing.

"Close the door.

I will tell you how to become rich.

Be greedy when others are fearful.

Be fearful when others are greedy."

WARREN BUFFETT, TO A GROUP OF UNDERGRADUATES AT COLUMBIA UNIVERSITY. HE WAS 23 YEARS OLD.

Subscribe

MARKET COMMENTARY

As 2011 begins, the **Shiller P/E ratio** of 10-year inflation-adjusted earnings for the S&P500 average stands at 24, far above the long-term mean of 16.4. Overall market valuations are rich, with deeply undervalued opportunities appearing relatively few and far between. While the financial excesses leading up to the 2009 credit crisis have destroyed billions of dollars in real wealth, the broader market has now risen nearly to levels last seen before the collapse. Market sentiment surveys and the continuing declines in volatility indexes reveal a growing complacency on the part of investors, even as a number of global factors including ballooning US deficits, near-defaults on European sovereign debt, and Mideast political turmoil create multiple sources of potential instability.

"It is far from certain that the typical investor should regularly hold off buying until low market levels appear, because this may involve a long wait, very likely the loss of income, and the possible missing of investment opportunities. On the whole it may be better for the investor to do his stock buying whenever he has money to put in stocks, except when the general market level is much higher than can be justified by well-established standards of value. If he wants to be shrewd, he can look for the ever-present bargain opportunities in individual securities."

BENJAMIN GRAHAM

It would seem a difficult time to resume a research newsletter focused on value investing.

As Benjamin Graham was among the first to point out, remaining uninvested for long periods during times of high overall market valuations is often a suboptimal strategy that prevents some naturally cautious value investors from achieving acceptable long-term returns. In one extreme example, observers such as James Grant correctly identified many concerning macroeconomic trends starting in the 1980s, but investors avoiding all US stocks for decades on this basis would have incurred high opportunity costs. Today's overall rich valuations have left few obvious opportunities meeting the criteria of a clear margin of safety; yet this makes it all the more important to maintain a consistent focus on picking a select few deeply undervalued securities likely to outperform in any market environment. In keeping with Dr Graham, we will attempt to be shrewd in carefully identifying a limited number of undervalued stocks likely to beat the market substantially.

HEDGING STRATEGIES FOR MARKET OVERVALUATION

In more recent years, practitioners of behavioral finance such as the mathematician Nassim Nicholas Taleb have demonstrated the substantial benefits of applying the growing knowledge of behavioral scientists about market participants' systematic misperceptions of long-term risk. In brief, people underestimate the likelihood of extreme adverse events and are repeatedly taken by surprise by unanticipated meltdowns such as the 1987 crash and the 2009 financial crisis.

Judicious use of small, carefully selected investments in instruments such as long-

dated out-of-the-money put options, which offer disproportionately large returns in crisis situations, can help to limit overall portfolio risk and generate substantial profits in the event of an unexpected market shock. Some highly leveraged or exorbitantly overvalued securities can have large and asymmetric downside risks that are not fully captured by options premiums. I have recently begun to allocate a small portion of my personal portfolio to LEAP put options on securities likely to fall very sharply in the event of an overall market decline, and will occasionally cover such opportunities in future issues for the benefit of like-minded investors.



S&P500 3-year price chart

Additionally, based on in-depth research and conversations with industry participants, I have recently identified a mid-capitalization biotechnology company which I believe has a high likelihood of undergoing a dramatic sales and earnings disappointment this year, and may represent a profitable opportunity for short selling with a definable near-term catalyst. Short selling carries significant risks and is not appropriate for many investors; but for sophisticated investors aware of the risk and willing to closely monitor a limited position, this represents one opportunity for potential profits from a richly valued market.



AUDITED PERFORMANCE RECORD

To objectively show the track record achievable from Deep Value investing in a real-world non-marginable account, I have had all statements of my personal Roth IRA brokerage account over the past seven years (the maximum period available) independently reviewed by a Certified Public Accountant, and am providing the results here and on the deepvalue.com website. As you may

know, I previously published a similar newsletter monthly from 2004-2005. I am also making **past writeups from this letter** available online.

As the SEC reminds us, past performance does not guarantee future results. However, based on the empirical finance literature showing outperformance of basic value strategies over long periods, the strongly positive track records of other value investors using a similar philosophy, and my personal experience in identifying mispriced securities for over thirteen years, it's my

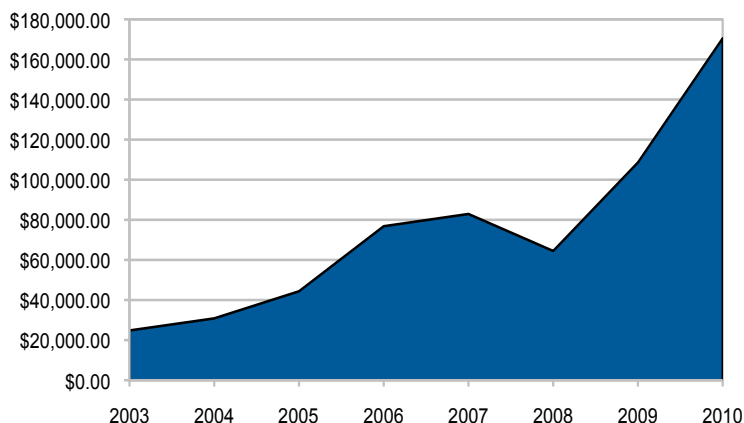
belief that a focused program of disciplined Deep Value investing will continue to deliver outstanding long-term returns for investors.

"To achieve satisfactory investment results is easier than most people realize; to achieve superior results is harder than it looks."

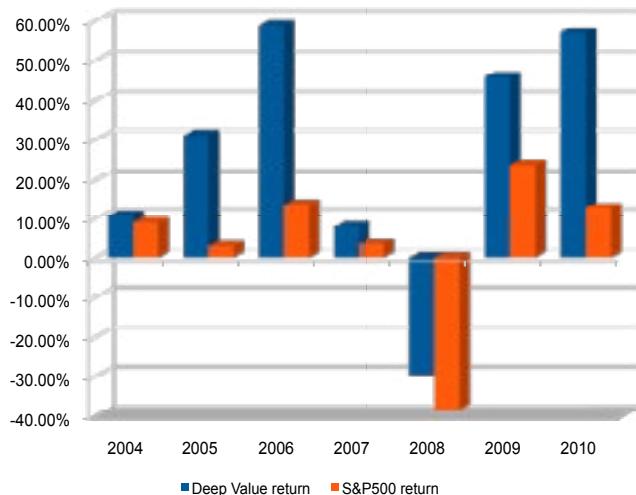
BENJAMIN GRAHAM

DEEP VALUE PERFORMANCE RECORD

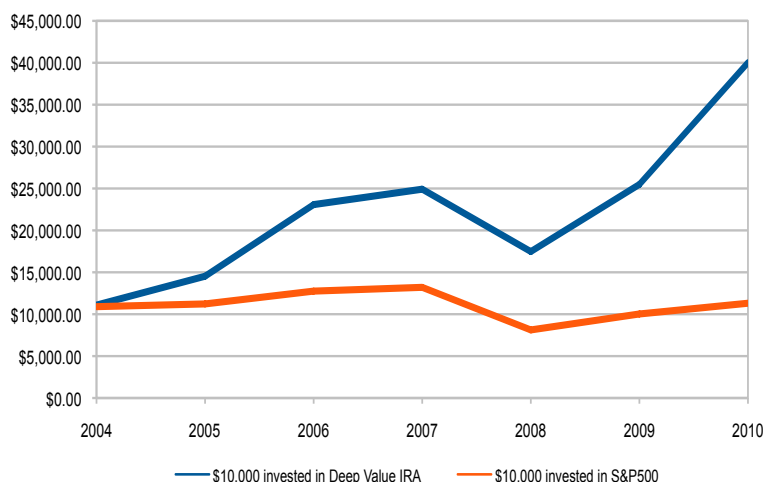
Total Account Value by Year (2003-2010)



Annual Percent Return Versus S&P 500 Average



Value of \$10,000 Invested in 2004



YEAR	DEEP VALUE RETURN	S&P500 RETURN	PERCENT OUTPERFORMANCE
2004	10.87%	8.99%	+1.88%
2005	31.06%	3.00%	+28.06%
2006	58.82%	13.62%	+45.20%
2007	7.97%	3.53%	+4.44%
2008	-29.87%	-38.49%	+8.62%
2009	45.84%	23.45%	+22.39%
2010	57.02%	12.78%	+44.24%

Undervalued: Adams Golf



Adams Golf (NASDAQ:ADGF) designs, manufactures and distributes mid to high end golf clubs under company-owned brands including Idea Pro, Speedline, Insight, Lady Fairway, Women's Golf Unlimited, and Square 2. Focused on technological and design innovation to build a strong brand reputation, Adams has consistently been winning significant market share across multiple product segments, and the business has returned to solid profitability ahead of other golf industry participants.

With no analyst coverage, the stock has yet to fully react to indications of significant earnings growth and an improving business outlook, in addition to the recent acquisition of a former competitor at bankruptcy auction on favorable terms that could drive significant further earnings growth this year. Remaining far below 2008 highs of \$10.20, ADGF shares are available at very attractive multiples to trailing and historical earnings, with a debt-free and cash-rich balance sheet further amplifying the mispricing and creating a generous margin of safety.

EARNINGS VALUATION

Beginning to recover from a sharp dropoff in consumer spending during the financial crisis, ADGF generated \$0.70 per share in fully diluted earnings in the trailing 12-month period, for a raw P/E ratio of 8.49 (a fraction of the current S&P500 average multiple of 24.08). With no debt and over \$1.37 per share in excess cash on the balance sheet, Adams' net-of-cash P/E for the trailing twelve month period is an attractive 6.47.

Valuations to recent historical earnings are even more striking - before the recent downturn (which included significant one-time charges from final settlement of a 2000 class action suit), Adams earned \$1.24 and \$1.32 per share in each of 2006 and 2007. Based on the lower of these numbers, the current multiple to historical earnings is just 4.75. Again, ADGF's solid balance sheet further enhances the margin of safety: adjusting for the \$1.37 per share net cash position would make the current P/E an eye-opening 3.65 on a historical basis. Simply continuing recent earnings performance should create generous returns for ADGF shareholders, while a return to anywhere near past levels of profitability could generate greater than +100% upside from current levels.

EARNINGS OUTLOOK

Management appears to have a disciplined track

record of capital allocation, and Adams has not been a serial acquirer. However, ADGF recently closed on a small but significant opportunistic acquisition, buying assets of former competitor Yes! Golf at bankruptcy auction. Although possessing a strong brand identity for its core putter products, the firm had struggled after an aggressive and poorly timed expansion, and working capital problems stemming from high leverage contributed to a precipitous decline in sales. The purchase price of \$1.65 million already represents a reasonable multiple to the firm's \$2.4 million of sales in 2010, but appears exceptionally attractive when compared to 2007 revenues of more than \$10.2 million. If Adams can leverage its existing infrastructure to improve margins, and drive an increase in sales regaining even fraction of prior levels, this acquisition could contribute to significant earnings growth over the coming years, potentially leading to PE multiple expansion as the firm's growth becomes better recognized.

<http://finance.yahoo.com/news/Adams-Golf-Acquires-Key-pz-2517033662.html?x=0&.v=1>

Adams' recent gains in market share appear to have been stimulated in part by perceived leadership in technological and design innovation, creating an increasingly positive brand identity that could lead to further sustainable improvements in market share and net margins. In January 2011, Adams products were honored with seven separate "Hot List" awards in Golf Digest's annual equipment issue, and Adams' Idea Tech V3 irons were selected as one of only four products to receive the Editor's Choice award.

<http://www.adamsgolf.com/press/01052011.php>

During late 2010 the company gained valuable publicity from multiple internationally televised events, with two golf pros on the Adams staff taking home several major championships using company clubs: Bernhard Langer winning both the U.S. Senior Open and Senior British Open, and Yani Tseng winning the Women's British and Australian Opens.

Due to the inherent seasonality of golf equipment sales, ADGF's results have been historically strongest during the first and second fiscal quarters (ending in March and June respectively). Results for the fourth quarter of 2010 should be reported in several weeks -- expected seasonal weakness could provide an opportunity to accumulate additional shares, although ADGF faces an easy comparison to a small reported

loss in the same period of 2009.

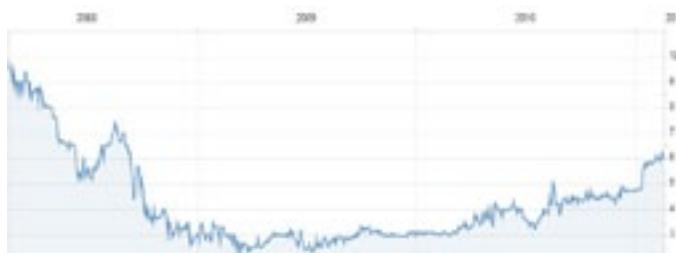
Adams generated an impressive \$0.63 in earnings in the second quarter of 2010 alone. With recent positive coverage from the press recommendations and tournament visibility described above, combined with significant operating leverage from the Yes! Golf acquisition, the spring and summer of 2011 could match or exceed prior levels.

BALANCE SHEET

Including \$10.3 million in cash, alone representing nearly a quarter of the \$44 million market cap, Adams' balance sheet has a total of \$52.4 million in current assets. (Although this doesn't adjust for the recent acquisition, cash flows over the coming quarters should more than recover this modest outlay.) Subtracting \$15 million in all liabilities shows net current assets of \$37.4 million, or more than \$5 per ADGF share. Improved working capital management has helped drive inventories down from \$33,611,000 at year-end 2008 to \$23 million today in the face of continuing sales growth, and receivables declined from \$28 million to \$18 million in the latest quarter.

On further review of the footnotes to the latest 10-K filing, Adams also had \$19.75 million in deferred tax assets at the end of the last fiscal year, \$9.5 million of which are not represented in reported book value under a valuation allowance. If recent profitability continues, this hidden asset could create over \$1.20 per share in additional shareholders' equity, bringing adjusted tangible book value to more than \$7.80 per share.

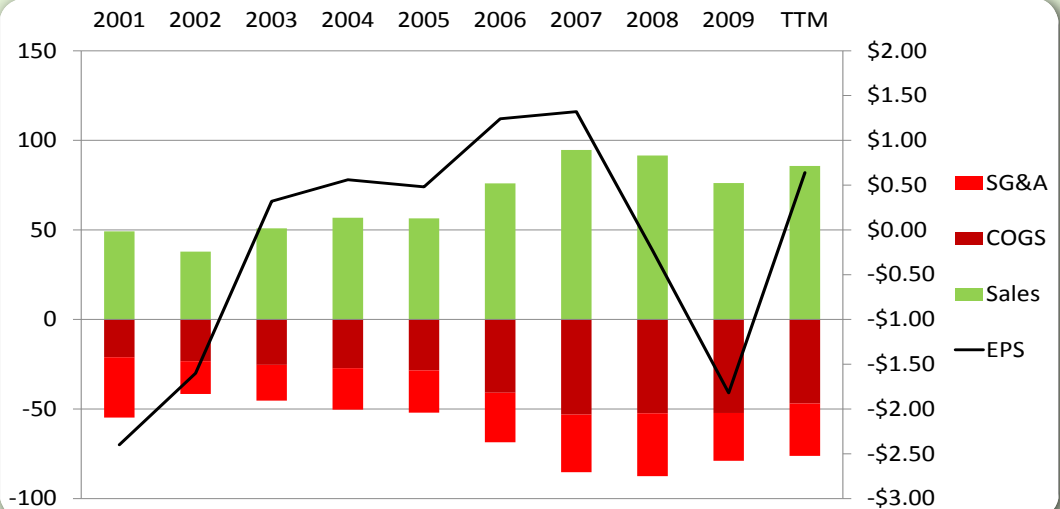
Adams owns 51 U.S. patents regarding various golf equipment technologies, and has a further 13 patent applications pending. The firm has invested over \$16 million in research and development since 2004, again implying significant value to intangible assets not present in GAAP book value numbers. Already trading at a discount to tangible book value, and with nearly one third of its market cap in cash, ADGF appears to have significant brand and intellectual property assets that could have substantial additional value to an acquirer.



Undervalued: Adams Golf (continued)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM
Revenue	49.2	37.9	50.9	56.8	56.4	76	94.6	91.5	76.1	85.7
COGS	-21.1	-23.3	-25.3	-27.2	-28.4	-40.9	-53.1	-52.4	-52.2	-46.9
Gross Profit	28.1	14.6	25.6	29.5	28.1	35.2	41.5	39	23.9	38.7
SG&A	-33.7	-18.3	-20	-23.2	-23.6	-27.7	-32.2	-35.1	-26.7	-29.3
R&D	-1	-1.4	-1.7	-1.8	-2.3	-2.6	-3.7	-3.8	-2.8	-2.5
Other	0	0	0	0	0	0	0	0	0	0
Operating Income	-13.2	-8.9	2.1	3.1	2	3.4	4.1	-1.4	-12.1	5.4
Net Interest	-0.4	0.2	0	-0.1	-1.3	-0.3	-0.6	0.1	0	0.1
Earnings Before Taxes	-12.8	-9.1	2.1	3.2	3.3	3.7	4.7	-1.5	-12.1	5.3
Income Taxes	0.6	-0.2	0.1	0.2	0.1	-5.3	-4.7	0	0.1	0.2
Earnings After Taxes	-13.4	-8.9	2	3.1	3.2	9	9.4	-1.5	-12.2	5.2
Net Income	-13.4	-8.9	2	3.1	3.2	9	9.4	-1.5	-12.2	5.2
Diluted EPS	-2.4	-1.6	0.32	0.56	0.48	1.24	1.32	-0.23	-1.82	0.64

Market Cap:	45.47M
Enterprise Value:	36.10M
Trailing P/E (ttm):	8.75
Price/Sales (ttm):	0.54
Price/Book:	0.94
EV/Revenue:	0.42
EV/EBITDA (ttm):	6.02



	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM
Cash	9.2	5.6	10.1	16.4	10.7	9.5	11.3	6	12.6	10.3
Short-Term Investments	0	0	0	0	0	0	0	0	0	0
Receivables	3.1	8.6	10.4	9.3	14.2	13.6	18	14.7	13.1	18.3
Inventory	17.4	9.1	8.1	11.6	16.2	24.7	28.7	33.6	19.7	23.1
Other Current Assets	1	1.1	0.5	0.3	0.8	1.9	2.2	1	0.4	0.7
Total Current Assets	30.7	24.4	29.1	37.6	41.9	49.7	60.2	55.3	45.8	52.4
Net PP&E	3.7	1.9	0.9	0.7	0.6	0.7	1	1.2	0.9	0.7
Intangibles	0	0	0	0	0	0	0	0	0	0
Other Long-Term Assets	0.4	0.1	0.1	0.1	1.6	5.2	10	10.6	10.5	10.5
Total Assets	34.8	26.4	30.1	38.4	44.1	55.6	71.2	67.1	57.2	63.6
Accounts Payable	0.5	0.9	1.2	3.9	4.7	6.3	9.2	9.5	5.5	4.9
Short-Term Debt	0	0	0	0	0	0	0	0	0	0
Accrued Liabilities	6	5.3	6	7.6	7.3	7.5	8.7	0	0	10.1
Other Short-Term Liabilities	0	0.1	0	0	0	-0.1	0	7.2	11.2	0
Total Current Liabilities	6.5	6.3	7.2	11.5	12	13.7	17.9	16.7	16.7	15
Long-Term Debt	0	0	0	0	0	0	0	0	0	0
Other Long-Term Liabilities	0.7	0.7	0.6	0.4	0	0	0	0	0	0
Total Liabilities	7.2	7	7.8	11.9	12	13.7	17.9	16.7	16.7	15
Total Equity	27.6	19.5	22.2	26.4	32.1	41.9	53.3	50.3	40.5	48.6
Total Liabilities & Equity	34.8	26.4	30.1	38.4	44.1	55.6	71.2	67.1	57.2	63.6

Overvalued: Avanir Pharmaceuticals



Avanir Pharmaceuticals (AVNR) is a marketing-stage biotechnology company whose single product I believe is likely to fail spectacularly on its introduction this year.

The company's flagship product is Nuedexta(TM), a combination of two generic drugs which was recently approved for treating symptoms of pseudobulbar affect (episodes of inappropriate laughter or crying) occurring in some patients with ALS (Lou Gehrig's disease) or multiple sclerosis. Following approval, AVNR's market cap more than doubled to nearly \$500 million; the company sold \$80 million of stock in a secondary offering and is beginning to aggressively ramp up spending on marketing Nuedexta, for which it lacks a pharmaceutical industry partner.

Apart from a wildly overestimated target market, Nuedexta has multiple serious issues relating to patent protection, efficacy, safety, competitive position, and cost that I believe will create an almost unsurmountable headwind to achieving any significant market penetration.

NUEDEXTA: PACKAGING A PILL

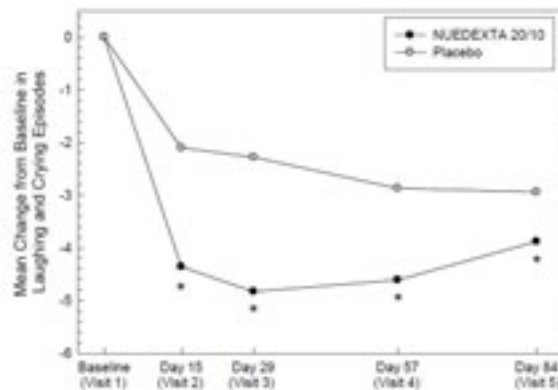
Nuedexta is in fact a combination of two existing generic drugs which have been around for decades. The active ingredient is dextromethorphan, which readers may recognize as also being the active ingredient in over-the-counter cough syrups such as NyQuil or Robitussin DM. According to the company, this generic substance "acts to control symptoms of pseudobulbar affect through an unknown mechanism".

The other ingredient is quinidine, a generic drug historically used in the management of heart arrhythmias, but included here for its role as an inhibitor of a liver enzyme called CYP2D6, thereby decreasing metabolism of dextromethorphan by the liver and making its circulating levels somewhat higher than if that drug were taken alone. Although effective in treating certain types of abnormal heart rhythms, quinidine is no longer widely used as it can cause various complications including a cardiac problem known as long QT syndrome, potentially leading in turn to a rapidly fatal ventricular arrhythmia if not treated promptly.

In fact, the FDA rejected Avanir's original application in 2006, citing concerns that its use of quinidine could cause serious arrhythmias, and forcing Avanir to begin a new clinical trial with a reformulated version using only one third of the previous dose of quinidine. After discontinuing most of its other

research programs to fund this study, AVNR spent millions to complete a revised Phase 3 trial which eventually led to approval in late 2010.

The results as provided by the company itself are shown below. At the end of the 12-week trial period, patients treated with Nuedexta had an average of 4 fewer episodes of laughing or crying per day -- a number which suddenly becomes much more underwhelming when compared with the average of 3 fewer episodes for patients treated with placebo alone. Less prominently mentioned is the fact that a total of six ALS patients in the groups treated with Nuedexta died during the 12-week study, compared to only one in the placebo group. Because of the number of patients enrolled in the trial the treatment did manage to reach the statistical significance needed for approval, but the actual clinical and human relevance of this kind of an impact is a different matter entirely. I seriously question the benefit of administering a sedating, exorbitantly priced, and potentially risky drug in order to obtain on average one fewer temporary episode of inappropriate laughter or crying. I think many physicians, patients, and families will question it as well.



Interestingly, there were no significant differences whatsoever seen between the 30/10mg and 20/10mg treatment arms. The lack of any dose-response relationship over this dose range could suggest the possibility of similar effects at even lower doses, such as those easily achievable through use of generic dextromethorphan alone.

Of course, no sane pharmaceutical company would fund that kind of trial. Because each of its ingredients have been available generically for decades, Avanir has no composition of matter patents pertaining to either one, relying on use and formulation patents covering its combination capsule. Doctors and pharmacists could easily provide the two ingredients separately at far



lower cost. (Or indeed, patients could simply purchase cough syrup themselves.)

The situation has strong parallels with the recent failure of NitroMed, a company which received FDA approval of its BiDil blood pressure capsule, which was also composed of two already available generic drugs. After struggling to gain acceptance from physicians, patients, and insurers, NitroMed ceased marketing efforts for BiDil and laid off most of its staff in January 2008, and was later sold for \$0.80 per share.

<http://online.wsj.com/article/SB120044147052292697.html>

Unlike NitroMed, which had a plausible marketing plan emphasizing the importance of a single pill in improving patient compliance, and research showing synergies between its two component ingredients in the African-American population, Avanir faces an uphill battle in marketing for a rare, controversial, and nonlethal condition for which numerous safe generic treatments are already available.

All this is particularly interesting given that Nuedexta's proposed cost per patient comes to \$5,868 per year.

That'll buy a lot of cough syrup.

Or a lot of amitriptyline, desipramine, fluoxetine, citalopram, fluvoxamine, sertraline, lamotrigine, or any of the other FDA-approved generic medications that have been used for decades in a wide variety of mood disorders, including pseudobulbar affect. Psychiatrists and neurologists are familiar with a wide range of existing medication options for emotional lability, each of which have more favorable cost and side effect profiles than Avanir's proposed alternative. In a PubMed search, I easily uncovered over 2 dozen published peer-reviewed studies showing safety and efficacy for numerous existing generic medications in the SSRI, tricyclic antidepressant, and mood stabilizer categories in treating symptoms of pseudobulbar affect:

Overvalued: Avanir Pharmaceuticals (continued)

<http://www.ncbi.nlm.nih.gov/pubmed/8937793>
<http://www.ncbi.nlm.nih.gov/pubmed/7711357>
<http://www.ncbi.nlm.nih.gov/pubmed/9782541>
<http://www.ncbi.nlm.nih.gov/pubmed/1770161>
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<http://www.ncbi.nlm.nih.gov/pubmed/11594930>
<http://www.ncbi.nlm.nih.gov/pubmed/16504590>

<http://www.ncbi.nlm.nih.gov/pmc/articles/PMC1963355>
<http://neuro.psychiatryonline.org/cgi/content/full/10/4/453>
<http://www.nejm.org/doi/pdf/10.1056/NEJM198506063122303>

To put costs in perspective, many of the above reasonable alternatives to Nuedexta are on the low-cost generic formulary at Walmartcosting just four dollars for one month's supply, a price which is matched by many retail pharmacies). Adding yet a further headwind to market acceptance, the quinidine contained in Nuedexta can create serious interactions with multiple widely-used classes of drugs, including tricyclic antidepressants and SSRIs. Patients dealing with issues of unstable mood may already be on one of these very medications, making their doctors even less likely to add a potentially risky and expensive drug like Nuedexta.

THE MARKETING OF PSEUDOBULBAR AFFECT: "MAKING A DIAGNOSIS"

Several months before approval, Avanir initiated a marketing effort intended to "raise awareness" among doctors and patients regarding pseudobulbar affect, the disorder Nuedexta is said to treat. Some perspective on PBA is provided by this excerpt from a New York Times article covering the approval:

Keith Katkin, chief executive of Avanir, said the company estimates that two million Americans suffer from the condition. "We like to refer to PBA as one of the most common diseases that people have never heard of," he said in an interview earlier this week.

Estimates are somewhat imprecise, however. Only five years ago the company was estimating that there were fewer than a million people with the condition.

The company faces a marketing challenge.

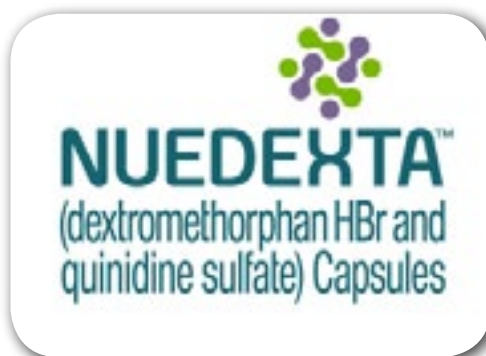
Many patients and doctors do not know the condition exists. And there is skepticism that PBA warrants treatment, given that people with the condition have more serious underlying diseases.

My estimates of the addressable target market are sharply lower than the company's figures.

It is more accurate to say that pseudobulbar affect is a symptom rather than a disease category. A minority of patients with certain neurological disorders can develop episodes of inappropriate laughter or crying; although some persons with particularly severe or prominent problems may seek treatment for that symptom and potentially be helped, for the most part pseudobulbar affect is generally far from the most serious or troubling issue that patients with these disorders confront.

15-40% of patients with ALS (also known as Lou Gehrig's disease or motor neuron disease) have problems with pseudobulbar affect. Particularly given the increased death rates in Avanir's study, more significant to patients and their families is that this incurable disease causes progressive generalized paralysis, eventually leading to death by respiratory failure. ALS is a rare disorder with approximately 30,000 patients in the US, each having an expected lifespan of 3 to 5 years.

Although there are approximately 300,000 multiple sclerosis patients in the US, the prevalence of similar symptoms in MS patients is much less frequent, and the availability of numerous safe and inexpensive generic alternatives is likely to drastically limit the addressable market.



Analysts associated with AVNR's multiple stock offerings have speculated about potential use of Nuedexta in various other populations such as stroke or Alzheimer's patients, while the company itself has avoided making any statements in this regard (wisely, in view of the increasingly steep fines being handed out by the FDA for any attempts

at off-label marketing). Apart from its potential cardiac risks, quinidine has anticholinergic effects (effectively opposite to many Alzheimer's drugs) making it particularly difficult to recommend for these patients.

In looking over the above data, I'm left somewhat astonished that this combination of two generic substances (one of which is available over the counter at convenience stores) is being perceived as a major new breakthrough product worth nearly \$500 million in market capitalization.

OTHER ASSETS AND OUTLOOK

Avanir has one other marketable product, a topical cold sore remedy known as Abreva. Its sales appear far from sufficient to sustain the company. AVNR generated a total of \$2.9 million in revenues in fiscal 2010, down from \$4.1 and \$7 million in the last two years.

The AVNR pipeline appears to be entirely devoid of any other credible development candidates.

Following the initial FDA rejection of Zenvia (now Nuedexta) in 2006, Avanir terminated its other research programs including the macrophage migration inhibitor AVP-28225. Avanir does retain a right to earn unspecified milestone payments if further advancements with AVP-28225 are made by Novartis. Since 2006, no further announcements that I could find have been made concerning this compound.

Lacking any other compounds in its pipeline, Avanir has hinted at plans to market Nuedexta for other indications, including as a pain medication. (The compound "AVP-923" listed in its promotional materials is in fact Nuedexta, presumably to be remarketed under yet another brand name.) Any attempt to win approval for pain could be particularly problematic, as dextromethorphan has known potential for abuse, causing pharmacists in some states to move DM-containing cold preparations behind the counter. Even more worrisome, patients taking increasing amounts of Nuedexta in an attempt to relieve pain could ingest a potentially dangerous dose of quinidine. In my view, attempts to market or approve Nuedexta in any other indication or jurisdiction will face the same overwhelming hurdles I have outlined above, and rapidly hasten consumption of the remaining cash.

On the heels of the FDA approval, AVNR promptly did a secondary offering of 20 million shares at \$4.40. Prior to this, stock sales over the past 3 years exceed \$78 million. Analysts associated with the offerings have come out with generous sales and

Overvalued: Avanir Pharmaceuticals (continued)

market size predictions for Nuedexta which the company should now prove extremely hard pressed to meet. Although cash from stock sales could last several years at the previous burn rate, Avanir lacks any pharmaceutical industry partner, and has been rapidly hiring sales personnel in what will almost certainly prove to be a futile attempt to build a sustainable market.

After purchasing \$19 thousand worth of stock at 43 cents in 2009, insiders have now sold hundreds of thousands of shares in the past 12 months, many at much lower prices. As the multiple barriers to market acceptance of Nuedexta become increasingly clear, AVNR appears likely to underperform the market significantly over the next six to twelve months.



Disclosures:

I hold a short position in Avanir Pharmaceuticals and a long position in Adams Golf, and may buy or sell shares in either security at any time without prior notice. I have accepted no payment from either company for research coverage. Nuedexta and Zenvia are trademarks of Avanir Pharmaceuticals.



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Saint Louis, MO

To whom it may concern:

We were engaged by Deep Value Investment Research to review the below listed annual account values and contributions made to their Roth IRA brokerage account for the periods ending December 31, 2003 – 2010.

	Account Value as of December 31,	Total Calendar Year Deposits
2003	\$24,820	n/a
2004	30,844	\$1,000
2005	44,356	3,000
2006	76,798	4,000
2007	82,917	0
2008	64,465	9,000
2009	108,602	10,000
2010	170,525	0

Current Value as of January 14, 2011: **\$210,883**

After obtaining account statements for the above periods directly from the brokerage itself, we verified that the account values and contributions made are accurate as presented. We make no representations regarding the sufficiency of this information for investment decision-making purposes. Past performance does not guarantee future results.

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Fairburn, GA

January 14, 2011

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