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DMC Bets Subsidiary to Secure \$3 Million from Top Shareholder

Document Security Systems (“DMC”) recently announced a new credit arrangement with Fagenson & Co., Inc. (“Fagenson”). According to DMC’s latest proxy statement, board member Robert B. Fagenson, president of Fagenson, owns 1,012,500 shares of DMC or 7.4% of the company. Though DMC has a supposed market capitalization of \$88.07 million, and no other debt, the company did not obtain the \$3 million from an outside lender. Instead, DMC borrowed from its largest shareholder.

To secure the \$3 million loan from Fagenson, DMC used its subsidiary, Plastic Printing Professionals, Inc. (P3) as collateral. According to DMC’s most recent 10K, the company outsources nearly all of its production, with the exception of the “secure plastic printed documents such as ID cards” produced by P3. In other words, DMC does not actually produce much and P3 is responsible for what it does produce. The good news for Fagenson is he will either profit from the DMC’s stock promotion as a shareholder or he will become owner of P3. The outlook is not so bright for DMC’s other shareholders.

In contrast to Fagenson, DMC’s less privileged investors must rely on the courtroom if they hope to see any profits from their shares. Not a hot prospect if one considers the past courtroom misadventures of DMC executives and insiders. The company is currently involved in litigation against the European Central Bank (“ECB”), claiming its Euronotes infringe on the company’s patented anti-counterfeiting technology. This technology, allegedly developed by Ralph Wicker, was also the subject of a lawsuit in the United States. In 1995, Ralph Wicker attempted to claim that the United States Treasury Department’s U.S. \$100 bill infringed upon intellectual properties covered by Ralph Wicker’s patents. Wicker’s lawsuit was dismissed; this dismissal was upheld on appeal in 2000. In 2000, Wicker’s sons brought the patents and technology featured in the 1995 suit to DMC where they hold executive positions. (See Related Article)

In addition to giving away its most valuable asset to its largest shareholder as collateral for a \$3 million loan, DMC has issued stock to its legal counsel in lieu of cash payments. Investors should note that DMC capitalizes all legal expenses associated with the defense of its patents. According to its 2006 10K, DMC amortizes the “legal costs associated with the development and defense of...patents, including the costs associated with [its] lawsuit against the ECB.” The company then places these expenses under “Other intangible assets, net” on its balance sheet.

The agreement between DMC and Fagenson expands the long list of irregular business activities associated with this ridiculous company, beginning with its miraculous transformation from a low-budget movie production operation into an alleged anti-counterfeiting technology company. Investors should remain wary of a spurious company claiming that litigation is a viable means to profits.