

# Mossberg's Investor Digest

May 2009

Issue #11

---

## From the Editor...

---

Next month will mark the first full year of Mossberg's Investor Digest, so I thought I'd let readers know how the ideas have performed.

Since July of 2008, there have been 48 ideas published in the letter. On average the ideas are up 7%, a full ten percentage points better than the market. Nearly two thirds, or 7 out of the 11 issues, have outperformed.

The best idea performance was Carriage Services (NYSE: CSV), which has increased 142% since it was published on March 30, 2009. The worst performance was from Dry Ships (Nasdaq: DRYS), which was published on July 15, 2008 and underperformed the market by 65 percentage points.

The thesis of the newsletter is that the best ideas of the smartest investors I know should outperform the market. So far...so good.

Thank you for your interest in Mossberg's Investor Digest. I welcome your feedback.

Dave Mossberg

---

## May 2009 Issue

---

**Signet Jewelers Limited (NYSE: SIG)** – \$17.76, May 15, 2009, Page 2 – The depressed economy and weak consumer spending makes SIG a bit of a contrarian play. However, shares currently trade at 4.6x EV/ EBITDA, which is an attractive valuation for an industry leader that has consistently produced return on equity in the mid to high teens. Valuation multiples should also improve as the UK-headquartered company becomes better known to U.S. investors.

**Smart Balance (Nasdaq: SMBL)** - \$7.71, May 15, 2009, Page 3 – Steve Hughes, the company's Chairman and CEO, along with other members of the management team, have an impressive track record of building and turning around brands in the consumer packaged food and beverage industry. Based on management's past track record, longer term, this company could be sold to a larger company at a much higher valuation.

**Virtus Investment Partners (Nasdaq: VRTS)** – \$15.15, May 22, 2009, Page 4 – Historically, money management firms trade at a ratio of approximately 2.5% of enterprise value to assets under management. VRTS trades at just 0.57%. As the company right-sizes its operating expenses and proves its ability to deliver industry margin levels, a return to historical valuations equates to a valuation multiple of 4x current levels.

**China 3C (OTCBB: CHCG)** - \$1.08, May 31, 2009, Page 5 – CHCG shares trade at just 2x earnings and 1x EV/ EBITDA. This valuation multiple is very attractive for a rapidly growing business with above 30% returns. There are added risks to Chinese-based operations and there will be a discount applied to the shares until the company is able to gain a U.S. exchange listing. However, \$0.55 per share in cash and a tangible book value of \$1.34 per share gives a considerable margin of safety to help offset these risks.

# Mossberg's Investor Digest

## Best Idea Profile

## Signet Jewelers Limited (NYSE: SIG)

### DESCRIPTION:

With 1,959 stores in the US and UK, Signet Jewelers is the world's largest (by sales) specialty jeweler. In the US (75% of sales and operating profit), the company operates 926 "every kiss begins with Kay" Jewelers stores, 171 "He went to Jared" The Galleria of Jewelry stores, and 304 regional brands. In the UK (25% of sales), the company operates H.Samuel and Ernest Jones stores and is larger than the next five UK competitors combined. Kay and H.Samuel are targeted at the middle mass market, while Jared and Ernest Jones are targeted at the upper middle market.

### KEY INVESTMENT CONSIDERATIONS:

**Economies of Scale allow for sustainable competitive advantage** – The scale of nearly 2,000 stores gives Signet significant advantages over its smaller competitors. Besides buying power, scale gives Signet the ability to use national television marketing to drive traffic to their stores. Despite producing higher operating profits than the industry, the company historically has spent 6.5% to 7.5% of sales on marketing, versus the industry average of approximately 4%. Closest competitor, Zale (NYSE: ZLC), spends 3% to 4%. Scale also allows the company to underwrite its own US customer credit. Over 50% of SIG's US sales are from in-house credit. Keeping credit in-house (versus outsourcing), allows them to capture the margin from financing and gives them greater control in managing customers' experiences.

**Sector rationalization is underway** – As you might imagine, the economy has been tough on jewelry retailers. During the last year, three of the top 10 middle market brands have liquidated or gone into chapter 11. Finlay, which owns Bailey, Banks and Biddle, will exit 500+ department stores, and close 50 of their 108 specialty jewelry stores. Zale has also announced a restructuring, closing of 115 stores. Of the 25,000 stores in the US, Signet estimates that 1,800 doors, representing 5% market share in dollar terms, were closed last year, a trend that is likely to continue during 2009. Sales were down 18.5% industry wide (versus 16% decline for Signet) during the holiday period, and volatile commodity costs, gold in particular, are making it challenging to manage costs. In addition, weaker operators are causing short-term disruption with heavy discounting related to clearing inventories or liquidation. While weaker competitors are going out of business and rationalizing their store bases, Signet is outperforming and continuing to produce a profit.

**Buying the best operator with the strongest balance sheet at the bottom of the cycle** – Historically, Signet has produced operating margin of 12%, twice the industry average. Despite challenging economic conditions, operating margin was 6.9% during fiscal 2009, which is much better than the competition. The company also maintains one of the strongest balance sheets in the industry, with credit agreements in place until 2013 and 2018 and a debt to equity ratio of 0.35. Also, recently amended credit facilities, give SIG less restrictive loan covenants. Operating profit, a strong balance sheet and an expected \$200 million in free cash flow during the current fiscal year, support the thesis that Signet will survive the downturn. As the economy emerges from the bottom of the cycle, profitably should return to historical levels and there will be less competition.

### VALUATION:

The depressed economy and weak consumer spending makes SIG a bit of a contrarian play. However, shares currently trade at 4.6x EV/ EBITDA, which is an attractive valuation for an industry leader that has consistently produced ROE in the mid to high teens. Valuation multiples should also improve as the UK-headquartered company becomes better known to U.S. investors. Just last year the company listed on NYSE and is clearly trying to gain attention among US investors.

#### (NYSE: SIG)

Investment Data (as of 5/11/09)

|   |                |
|---|----------------|
| <b>Recent Price</b>                           | <b>\$17.76</b> |
| 52-Week Range                                 | 5.91 - 30.64   |
| Fiscal Year End                               | January        |
| Dividend                                      | N/A            |
| Yield   | N/A            |
| Shares Outstanding                            | 85.3 MM        |
| Average Trading Volume (3 mos)<br>(NYSE Only) | 360,000        |
| Market Capitalization                         | 1.5 B          |
| Cash  | 97 MM          |
| Long Term Debt                                | 568 MM         |
| Enterprise Value (EV)                         | 1.9 B          |
| LT Debt/ Equity                               | 0.35           |
| BV/ Share                                     | 18.61          |
| TTM Revenue                                   | 3.3 B          |
| P/ Revenue                                    | 0.5x           |
| TTM EPS (non-GAAP)                            | 1.57           |
| P/ EPS  | 11.2x          |
| TTM adjusted EBITDA                           | 337 M          |
| EV/ TTM EBITDA                                | 5.6x           |

We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea profiles are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Additional disclosures can be found under the Disclosures portion of the Mossberg's Investor Digest website.

# Mossberg's Investor Digest

## Best Idea Profile

Smart Balance (Nasdaq: SMBL)

### DESCRIPTION:

Headquartered in Paramus, NJ, Smart Balance is the second largest marketer of buttery spreads in the United States. Products are marketed to grocery, mass merchandise and convenience stores under the brand names Smart Balance and Earth Balance and sold at a slight premium (about 10%) compared to the rest of the category. Buttery spreads (Approximately 75% of sales) is by far the most developed product. The company has also introduced peanut butter, cooking oils, mayonnaise, popcorn and dairy products.

### KEY INVESTMENT CONSIDERATION:

**Dominate brand in a category with secular growth** – Consumers are placing greater emphasis on eating healthy. According to the International Foods Information Council, the number one health concern among consumers is heart health. Based on this concern, the healthy premium category of spreads has grown 60% from 2002 to 2007 and comprises approximately 18% of the spreads market. Smart Balance, which accounts for approximately 70% of the healthy premium category, has been largely responsible for the category growth. Since 2005, SMBL sales have grown at a CAGR of 31%. Sales grew 26% in 2008.

#### (Nasdaq: SMBL)

Investment Data (as of 5/15/09)

|                                |               |
|--------------------------------|---------------|
| <b>Recent Price</b>            | <b>\$7.71</b> |
| 52-Week Range                  | 4.58 - 9.45   |
| Fiscal Year End                | December      |
| Dividend                       | N/A           |
| Yield                          | N/A           |
| Shares Outstanding             | 62.6 MM       |
| Average Trading Volume (3 mos) | 621           |
| <b>Market Capitalization</b>   | <b>482 MM</b> |
| Cash                           | 8.1 MM        |
| Long Term Debt                 | 69 MM         |
| Enterprise Value (EV)          | 542 MM        |
| LT Debt/ Equity                | 0.2           |
| Tangible BV/ Share             | N/A           |
| TTM Revenue                    | 234 MM        |
| <b>P/ Revenue</b>              | <b>2.0x</b>   |
| TTM EPS                        | -0.07         |
| <b>P/ EPS</b>                  | <b>N/A</b>    |
| Adjusted EBITDA                | 26.9 MM       |
| <b>EV/ TTM EBITDA</b>          | <b>20x</b>    |

**Exclusive license and patent protection gives competitive advantage** – About ¾ of the company's products used proprietary technology that enhances good-to-bad cholesterol ratios and still tastes good.

**Virtual business model requires limited capital to support growth** – The company outsources its manufacturing and distribution and has limited need for capital expenditures. The company has already made infrastructure investments; IT infrastructure, systems, etc. required to quadruple the size of the business without the need for significant capital spending. In addition, there is significant leverage in this business model. There are only 60 employees in the company and management claims they only need to grow to 75 to 80 people to support twice as much revenue.

**Betting on the Jockey** – Steve Hughes, the company's Chairman and CEO, along with other members of the management team, have an impressive track record of building and turning around brands in the consumer packaged food and beverage industry. Steve's track record includes leading the Healthy Choice brand from zero to \$1 billion in sales, turning Tropicana's US business around, doubling Tropicana's sales from \$1 billion to \$2 billion (ultimately sold to Pepsi for 3.3 billion), and increasing Celestial Seasonings from \$80 million in sales, which was ultimately sold to Hain for \$387 million in three years.

### VALUATION:

The company is investing considerable sums in brand advertising, \$40 million in 2008 and \$50 million is expected during 2009. With this level of investment, profitability levels are near breakeven to a slight loss, making it impossible to value the stock based on a multiple of earnings. Based on an adjusted EBITDA (adjusted for stock options)/to Enterprise value of 20x, it appears the stock is fully valued. However, the company is growing at an aggressive rate and entering new categories with significant market potential. Small, fast growing companies in the food business typically don't last long as independent companies. Based on management's past track record, the company could be sold to a larger company at a much higher valuation.

We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea profiles are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Additional disclosures can be found under the Disclosures portion of the Mossberg's Investor Digest website.

# Mossberg's Investor Digest

## Best Idea Profile

## Virtus Investment Partners (Nasdaq: VRTS)

### DESCRIPTION:

Headquartered in Hartford Connecticut, Virtus Investment Partners is an investment management firm with approximately \$21 billion under management. The company manages money for individuals and institutions through a group of affiliated and unaffiliated managers with multiple independent investment strategies. Virtus was spun out of The Phoenix Companies (NYSE: PNX) on December 31, 2008.

### KEY INVESTMENT CONSIDERATION:

**Removal of corporate burden will aid in restoring margins to nominal industry levels** – Because it was part of a larger corporation, Virtus' corporate burden was excessive and not indicative of the profitability levels that can be produced based on its book of business. The company is in the process of right-sizing its operations and reducing the corporate burden it inherited from The Phoenix Companies. For example, the company has reduced its annual corporate office rent expense from \$2.8 MM to \$0.8 MM; human resources expense from \$3.0 MM to \$0.7 MM; and communications expenses from \$1.3 MM to \$0.4 MM.

**Good business with great returns** - With normalized industry EBITDA margins in the 20% to 40% range, the money management business is highly profitable, requires limited capital and delivers strong returns.

**Opportunity for the best managers to take market share** – Given the turmoil in capital markets investors are firing their long-time money managers and hiring new ones. Unlike the good times of a bull market, this means market share is up for grabs and those managers with the best records will take share. About a third of the funds managed by Virtus' affiliates have Morningstar ratings of 4 and 5 stars and the majority of the funds are 3 stars.

**Sizable deferred tax loss carry forward could be a hidden asset.** – The company has a deferred tax asset of \$115 million that represents Virtus' share of the tax loss carry forward of its former parent. The company has recorded a valuation allowance of \$108 million against the tax asset, because according to the accountants, the valuation has to be "objectively verified". At the time of the spin out it was challenging to "objectively verify" the company's future growth and profitability. If management is successful in restoring growth and profitability, it's possible the valuation allowance could be removed. This means the company's tax bill will be substantially reduced in the coming years.

### VALUATION:

Virtus was spun out of its former parent in a taxable transaction, which is fairly atypical and puts selling pressure on the stock for those shareholders who need to sell part or all of their shares to meet the tax obligation. Since the beginning of the year, approximately 90% of the float has traded, which means it is likely that this tax affected selling is complete and there will be less artificial downward pressure on the shares. Before the company was spun out from The Phoenix Companies, Virtus sold a 23% equity stake for \$45 million to Harris Bankcorp, which would imply a valuation over \$30 per share. For Harris to complete a transaction in October of 2008 (one of the most uncertain times in the history of global financial markets) and pay a price that is more than 2x today's levels implies a large vote of confidence from Harris. Longer term, Harris, which is owned by BMO Financial Group, is a likely acquirer of Virtus. Historically money management firms trade at a ratio of approximately 2.5% of enterprise value to assets under management. VRTS trades at just 0.57%. As the company right-sizes its operating expenses and proves its ability to deliver industry margin levels, a return to historical valuations equates to a valuation multiple of 4x current levels.

### (Nasdaq: VRTS)

Investment Data (as of 5/22/09)

|                                |                |
|--------------------------------|----------------|
| <b>Recent Price</b>            | <b>\$15.15</b> |
| 52-Week Range                  | 3.78 - 15.92   |
| Fiscal Year End                | December       |
| Dividend                       | N/A            |
| Yield                          | N/A            |
| Shares Outstanding             | 5.8 MM         |
| Average Trading Volume (3 mos) | 68,000         |
| <b>Market Capitalization</b>   | <b>88 MM</b>   |
| Convertible Preferred Stock    | 46 MM          |
| Cash                           | 27 MM          |
| Long Term Debt                 | 12 MM          |
| Enterprise Value (EV)          | 119 MM         |
| LT Debt/ Equity                | 0.5            |
| Tangible BV/ Share             | N/A            |
| TTM Revenue                    | 153 MM         |
| <b>P/ Revenue</b>              | <b>0.6x</b>    |
| TTM EPS                        | n/a            |
| <b>P/ EPS</b>                  | <b>n/a</b>     |

We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea profiles are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Additional disclosures can be found under the Disclosures portion of the Mossberg's Investor Digest website.

# Mossberg's Investor Digest

## Best Idea Profile

China 3C (OTCBB: CHCG)

### DESCRIPTION:

Headquartered in Hangzhou, China 3C is a wholesale distributor and retailer of consumer electronics in Eastern China. The company gets its name from its focus on 1) computers, 2) communication products and 3) consumer electronics. The company operates over 1,000 "store-in-store" locations, which differs from the typical U.S. model, but is more common in China. The company operates four reportable segments including:

- 1) Yiwu Yong Xin, (290+ stores, 20% of revenue) focuses on fax machines and corded phone products.
- 2) Hangzhou Wang Da, (250+ stores, 33% of revenue) focuses on mobile phones and related products.
- 3) Hangzhou Sanhe, (230+ stores, 22% of revenue) focuses on home electronics.
- 4) Shanghai Joy & Harmony, (220+ stores, 24% of revenue) focuses on MP3 players and related products.

At the time of its 2008 10k filing, the company had 1,807 employees.

### KEY INVESTMENT CONSIDERATION:

**Significant growth** – The company has enjoyed considerable growth in the past few years, more than doubling sales since 2006. The "store-in-store" business model, allows for rapid expansion as there is no capital outlay for real estate and the in-store build is less. While recent growth trends have slowed (2008 revenue grew 12%), the company has ample growth opportunities. The company has recently launched a franchise model to serve smaller cities in Easter China, with plans to open 30 stores in 2009 and 100 in 2010.

**Inventory turnover is key in this business** – With the "store-in-store" model, China 3C assumes the inventory risk and hires and manages employees who work at the location. This model allows for specialization in product categories, similar to "category killers" such as Best Buy in the United States. With specialization, the company is able to mitigate merchandising risk, which is particularly important given the rapid rate of obsolescence in consumer electronics. China 3C turns inventory 24 times per year. By way of comparison, Best Buy turns inventory 7 times per year, RadioShack 4 times, and Wal-Mart 9 times. The model does require working capital in the form of receivables from the retailers that host the company's stores, however, return on assets for 2008 was still North of 30%...quite impressive.

### RISK:

Operating in China carries its own set of risks, including potential weakness in the Chinese economy and its affect on the Chinese consumer. In addition, laws and regulations can be rapidly changed at the whim of the government.

China 3C's stock is traded OTC Bulletin Board, which is a less efficient market than Nasdaq, or other national exchanges. In addition, there is limited trading volume. Both of these factors lead to greater stock price volatility and inefficient pricing.

### VALUATION:

CHCG shares trade at just 2x earnings and 1x EV/EBITDA. This valuation multiple is very attractive for a rapidly growing business with above 30% returns. There are added risks to Chinese-based operations and there will be a discount applied to the shares until the company is able to gain a U.S. exchange listing. However, there is a considerable margin of safety to help offset these risks. The company has \$29 million in cash and no debt. Also, at the current level, shares are trading at a 20% discount to tangible book value.

#### (OTCBB: CHCG)

Investment Data (as of 5/29/09)

|                                |               |
|--------------------------------|---------------|
| <b>Recent Price</b>            | <b>\$1.08</b> |
| 52-Week Range                  | 0.37 - 2.42   |
| Fiscal Year End                | December      |
| Dividend                       | N/A           |
| Yield                          | N/A           |
| Shares Outstanding             | 52.8 MM       |
| Average Trading Volume (3 mos) | 150,000       |
| <b>Market Capitalization</b>   | <b>57 MM</b>  |
| Cash                           | 29 MM         |
| Long Term Debt                 | 0             |
| Enterprise Value (EV)          | 28 MM         |
| LT Debt/ Equity                | 0             |
| Tangible BV/ Share             | 1.34          |
| TTM Revenue                    | 320 MM        |
| <b>P/ Revenue</b>              | <b>0.2x</b>   |
| TTM EPS                        | 0.47          |
| <b>P/ EPS</b>                  | <b>2.3x</b>   |
| EBITDA                         | 31.4 MM       |
| <b>EV/ TTM EBITDA</b>          | <b>0.9x</b>   |

We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea profiles are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Additional disclosures can be found under the Disclosures portion of the Mossberg's Investor Digest website.

# Mossberg's Investor Digest

## Subscription Information

---

Subscribe to Mossberg's Investor Digest at [www.mossbergid.com/subscribe.html](http://www.mossbergid.com/subscribe.html)

### **Immediate Access Annual Subscription: \$245/ year**

**12 Monthly Compilation Issues** – At the end of each month, Mossberg's Investor Digest compiles all Best Idea Profiles generated that month into a single compilation issue.

**Access to Past Compilation Issues** – Password protected access to all previous compilation issues.

**Immediate Access to Best Idea Profiles** - Approximately two to three times per month, Immediate Access Annual Subscribers receive Best Idea Profiles as soon as they are published.

### **Annual Subscription: \$195/ year**

**12 Monthly Compilation Issues**

**Access to Past Compilation Issues**

## About Mossberg's Investor Digest

---

The value proposition of the digest is essentially an "Idea Generator". During the course of my 13-year career in capital markets, I've had the chance to meet and work closely with some very smart professional investors who have consistent track records of outperforming the market indexes. Some of these investors, which include mutual fund managers, hedge fund managers, and other professional investors, are kind enough to share their best ideas with me. I conduct my own analysis of their ideas and publish summaries of those ideas I think represent timely investment opportunities. Over time, I trust the majority of these ideas will pan out and help subscribers generate index-beating returns.

The goal of the Best Idea Profiles in this newsletter is to describe all of relevant investment merits and risks of a company in one page. It is not intended to be an exhaustive report including every detail of a company. With limited space available, I am forced to include only those data points that I feel are most important for subscribers to know before they begin their own due diligence. Thank you for your interest in Mossberg's Investor Digest.

## Disclosures

---

**Not Investment Advice:** Investors should consult a financial advisor before investing in any securities highlighted in the Digest or subscribing to any newsletter service. We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea Profiles highlighted in Mossberg's Investor Digest are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Mossberg's Investor Digest is not suitable for people seeking low to moderate risk investments.

It is the policy of the publisher to follow the CFA Institute's "Standards of Practice" regarding disclosure of potential conflicts of interest. The publisher's policy is to avoid conflicts of interest when possible. However, when potential conflicts are unavoidable, the publisher's policy is to disclose material business relationships between it and issuers of securities highlighted in the letter. In addition, the publisher's ownership in securities highlighted in the letter is disclosed. By disclosing potential conflicts of interest, subscribers and prospective subscribers will have additional information to evaluate the objectivity of ideas highlighted in the newsletter.

\*There are no material business relationships between the publisher and the securities highlighted in this issue.

\*The publisher owns shares in DELL, ITWO, ISSI, OPMR, and WU.

---

We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea profiles are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Additional disclosures can be found under the Disclosures portion of the Mossberg's Investor Digest website.

[www.mossbergid.com](http://www.mossbergid.com)