

# Mossberg's Investor Digest

July 2012

Issue #49

From the Editor...

July 2012 Issue

**Measuring management effectiveness by decomposing returns** – I am a big fan of the Du Pont Identity Method or Decomposition Method and often use it to evaluate investments. Essentially the Du Pont method breaks down Return on Equity into three parts. 1) Net Margin 2) Asset Turnover, and 3) equity multiplier. The formula looks like this.

$$\begin{aligned} & (\text{NI}/\text{Sales}) \times (\text{Sales}/\text{Assets}) \times (\text{Assets}/\text{Equity}) = \text{ROE} \\ & \text{or,} \\ & (\text{Net Income}) \times (\text{Asset Turnover}) \times (\text{Equity Multiplier}) = \text{ROE} \end{aligned}$$

If you cancel out **sales** and **assets** in the formula, you get back to the simple calculation, which is  
 $\text{NI}/\text{Equity} = \text{ROE}$

The way I think about this formula is that management has three levers that it can pull to deliver returns.

**lever 1: Net Income** - Net Income is the common metric that management teams focus on. Self explanatory.

**lever 2: Asset Turnover** - This is an important metric that more management teams should focus on. Essentially it gives us how much sales a company can produce with a given amount of assets. Even though a company may have a low net margin, if they can turn their assets several times a year/month, then they can drive good returns. Think of a car dealer....A dealer sells cars on thin margin, let's say it's 5%. After he pays for variable, fixed and borrowing costs, a dealer clears 1%. However, if the average car sits on his lot for less than 30 days, he can make 1% 12 times per year, which can be an attractive return.

**lever 3: Equity Multiplier** - This is a measure of how much leverage management is using to drive returns. Getting terms from suppliers (accounts payable) is a good thing. Putting on too much bank debt can add more risk.

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

Dave Mossberg

**Compass Diversified Holdings (NYSE: CODI)** - \$14.06, July 7, 2012, Page 3 - CODI offers a unique public vehicle for investing in what is essentially a private equity fund. The company has good liquidity and reasonable debt, making further acquisitions an almost certain expectation. The stock appears reasonably priced based with a P/E of less than 10, and a 10% payout makes it fairly easy for investors to wait out anticipated stock price improvement.

**Codexis (NASDAQ:CDXS)** - \$3.23, July 29, 2012, Page 4 - Codexis develops microorganisms and enzymes that enable cost-advantaged production of biofuels, bio-based chemicals and pharmaceuticals. Investors' inability to look into the future undermines the current price of this stock. The stock is trading near it's yearly low despite having one strong business currently generating impressive results and two other businesses with substantial upside.

**Silicon Motion Technology Corp. (NASDAQ:SIMO)** - \$15.33, July 29, 2012, Page 5 - Silicon Motion designs, develops and supplies multimedia data processing, storage and transfer solutions primarily for the OEMs of consumer electronics applications. There has been some concern about industry weakness affecting the Company's core businesses. The Company expects this to pick up, as well as to have less impact as its new-growth businesses become a larger percentage of the total. With great growth momentum and consistent outperformance of estimates, the stock should continue higher.

**Franklin Covey Co. (NYSE:FC)** - \$10.27, July 29, 2012, Page 6 - Franklin Covey recently implemented a stock repurchase plan and started buying the stock in late July. The stock has shown good momentum since then. The July 16<sup>th</sup> death of the guru author and inspiration for much of the company's content, Stephen R. Covey, should not impact performance of the company.

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# Mossberg's Investor Digest

## Mossberg's Investor Digest Idea Performance

The table below shows the relative change in the value of the ideas published since November 2011 and the Russell 3000. **Performance data quoted represents past performance and does not guarantee future results.** Current performance of ideas may be lower or higher than the performance quoted.

Company	Pub. Date	Original Price	Recent Price	Change	Russell 3000 Change Since Pub. Date	Relative Perf. vs. Russell 3000
Firsthand Technology Value Fund (Nasdaq: SVVC)	22-Nov-11	14.30	16.08	12.4%	15.5%	-3.1%
Wilhelmina International (OTCBB: WHLM)	22-Nov-11	0.19	0.13	-32.8%	15.5%	-48.3%
American Axel (NYSE: AXL)	27-Nov-11	7.51	10.17	35.4%	18.6%	16.8%
GraphTech (NYSE: GTI)	27-Nov-11	12.51	9.39	-24.9%	18.6%	-43.6%
Headwaters, Inc. (NYSE: HW)	9-Dec-11	2.74	5.62	105.1%	9.3%	95.8%
3D Systems Corp. (NYSE: DDD)	23-Dec-11	14.95	34.91	133.5%	8.5%	125.0%
Wilbros Group, Inc. (NYSE: WG)	23-Dec-11	3.71	7.04	89.8%	8.5%	81.3%
Antares Energy (ASX: AZZ.AX)	31-Dec-11	0.43	0.41	-5.8%	9.3%	-15.1%
Rentech Nitrogen Partners L.P. (NYSE:RNF)	12-Jan-12	19.25	29.58	53.7%	5.8%	47.9%
Points International, Ltd. (NASDAQ:PCOM)	23-Jan-12	7.96	12.83	61.2%	4.1%	57.0%
Conn's Inc. (NASDAQ:CONN)	24-Jan-12	11.95	16.88	41.3%	4.1%	37.1%
Trinity Industries, Inc. (NYSE:TRN)	26-Jan-12	31.30	23.83	-23.9%	3.7%	-27.6%
Top Image Systems (Nasdaq: TISA)	18-Feb-12	2.92	4.31	47.6%	0.2%	47.4%
DGSE Companies (Nasdaq: DGSE)	27-Feb-12	7.72	7.43	-3.8%	-0.1%	-3.6%
Doral Financial (NYSE: DRL)	27-Feb-12	1.49	1.45	-2.7%	-0.1%	-2.6%
Essex Rental Corporation (Nasdaq: ESSX)	27-Feb-12	3.60	4.01	11.4%	-0.1%	11.5%
Plug Power, Inc. (NASDAQ:PLUG)	19-Mar-12	1.77	1.15	-35.0%	-2.9%	-32.1%
Salem Communications (NASDAQ:SALM)	28-Mar-12	4.52	5.19	14.8%	-2.6%	17.4%
21st Century Holding (NASDAQ:TCHC)	29-Mar-12	4.43	4.54	2.5%	-2.4%	4.9%
HFF, Inc. (NYSE: HF)	30-Mar-12	16.47	14.96	-9.2%	-2.7%	-6.4%
Hecla Mining, Inc. (NYSE:HL)	26-Apr-12	4.25	4.37	2.8%	-2.1%	4.9%
The Cash Store Financial Services, Inc. (NYSE:CSF)	26-Apr-12	5.37	5.87	9.3%	-2.1%	11.4%
Silicon Image, Inc. (NASDAQ:SIMG)	29-Apr-12	5.95	3.90	-34.5%	-2.4%	-32.0%
GSE Systems Inc. (Amex: GVP)	29-Apr-12	2.87	2.33	-18.8%	-2.4%	-16.4%
GSI Group (Nasdaq: GSIG)	13-May-12	12.36	10.73	-13.2%	1.2%	-14.4%
Standard Parking Corp. (NASDAQ:STAN)	25-May-12	18.42	22.40	21.6%	4.1%	17.5%
Ionnodata Isoqen (Nasdaq: INOD)	28-May-12	5.41	6.59	21.8%	4.1%	17.7%
Acme United (Amex: ACU)	30-May-12	10.17	10.37	2.0%	4.5%	-2.5%
Spectrum Pharmaceuticals, Inc. (Nasdaq: SPPI)	3-Jun-12	11.01	16.39	48.9%	7.5%	41.4%
Matrix Service Co. (Nasdaq: MTRX)	8-Jun-12	10.46	11.61	11.0%	3.7%	7.3%
Orbital Sciences Corp.(NYSE: ORB)	13-Jun-12	12.02	13.19	9.7%	4.8%	4.9%
Landec Corp.(Nasdaq: LNDC)	18-Jun-12	7.55	8.56	13.4%	2.4%	11.0%
				<b>17.0%</b>	<b>4.2%</b>	<b>12.8%</b>

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## Best Idea Profile:

## Compass Diversified Holdings (NYSE: CODI)

### DESCRIPTION

Compass Diversified Holdings lives up to its name as an owner of a diversified mix of middle market businesses (average \$100 million in revenue) that focus on niche products or services that are not facing obsolescence, that have good management, and that have room for improvement in revenue and/or efficiencies. Compass currently owns majority interests in the following eight companies, most of which are market share leaders in their niche businesses.

- **Advanced Circuits** - Manufactures printed circuit boards in the U.S. It's quick turn business gives competitive moat vs. Asian manufacturers. Produces approximately \$80 Million in revenue with 40% EBITDA margins.
- **CamelBak** - Market leader in personal hydration products such as the back packs popular with outdoor enthusiasts. Produces approximately \$140 in Revenue with 22% EBITDA margin.
- **Fox Racing Shox** - Designs and develops high performance shock absorbers and racing suspension products for mountain bikes and off-road vehicles. Approximately \$200 million in revenue with 16% EBITDA margin.
- **Arnold Magnetic Technologies** - Manufactures engineered permanent magnet and magnet assemblies. Approximately \$130 million in revenue with 13.2% EBITDA margin.
- **Ergobaby** - Manufactures premium baby carriers. Produces approximately \$45 million in revenue with 26% EBITDA Margin.
- **Liberty Safe** - Manufactures home and gun safes. Approximately \$82 million in revenue with 14% EBITDA Margin.
- **Tridean Medical** - Produces medical support surfaces (specialty beds, mattress replacements). \$60 million in revenue with 14% EBITDA Margin.
- **American Furniture** - Manufactures low-cost domestic upholstered furniture. Approximately 105 million in revenue and lost \$4 million during 2011.

Compass has no direct employees as it is operated through its management company, CGM, based out of Connecticut.

### KEY INVESTMENT CONSIDERATIONS:

**Dividend Yield** - The stock is paying a \$1.44 per share annualized dividend, which yields more than 10% return. The company has a history of increasing dividend payouts and has paid out \$7.80 in dividends since its IPO in May 2006.

**History of Success Since IPO** - Compass employs a strategy to pursue businesses that can benefit from its management expertise. Compass looks for companies that have opportunities in organic or external growth or operating efficiencies. It also provides ongoing strategic and financial support to its businesses. Compass has sold five businesses since its IPO for approximately \$198 million. Sales of these businesses for a profit increase cash flow and help to ensure that Compass meets its distribution plans in the short term and its realized gains in the longer term.

### RISK AND VALUATION:

CODI offers a unique public vehicle for investing in what is essentially a private equity fund. The company has good liquidity and reasonable debt, making further acquisitions an almost certain expectation. The stock appears reasonably priced based with a P/E of less than 10, and a 10% payout makes it fairly easy for investors to wait out anticipated stock price improvement.

#### Compass Diversified Holdings (NYSE: CODI) Investment Data (as of 7/06/12)

Recent Price	\$14.06
52-Week Range	\$17.29 - \$11.21
Fiscal Year End	December
Dividend	\$1.44
Yield	10.2%
Shares Outstanding	48 M
Average Trading Volume (3 m)	325 K
Market Capitalization	\$680 M
Cash	\$22 M
Debt	\$298 M
Enterprise Value (EV)	\$954 M
Book Value/share	\$9.90
TTM Revenue	\$833 M
P/ Sales	0.8x
TTM EPS	\$1.49
P/ EPS	9.5x
2011 EBITDA*	\$139 M
EV/ EBITDA	6.7x
* Proforma 2011	

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## Best Idea Profile:

Codexis (NASDAQ:CDXS)

### DESCRIPTION:

Codexis develops microorganisms and enzymes that enable cost-advantaged production of biofuels, bio-based chemicals and pharmaceuticals. The best way to understand this company is to delve into its parts. CodeXyme enzymes enable fuels and chemicals to be made from renewable resources, versus most of today's fuels and chemicals coming from non-renewable petroleum resources. CodeXol uses detergent alcohols to manufacture surfactants, which are then formulated into household detergents and personal care products that are made from sustainable sources. Pharma is the Company's established and growing business that produces enzymes that are used in the production of drugs, including the blockbuster drugs Lipitor and Januvia. The Company was founded in 2002 in Redwood, California, and has 340 employees. The stock went public in April 2010.

### KEY INVESTMENT CONSIDERATIONS:

**Uncertainty creates opportunity** – Codexis stock has been hurt by change and uncertainty: there has been a turnover at the senior management team (New CEO appointed in June 2012), and the critical research partnership with Shell comes up for renewal in the Fall. The CEO comes from the specialty chemical industry (prior management was more experienced in pharmaceuticals). While a less developed area for Codexis, specialty chemicals have tremendous long-term upside and it makes sense for the Company to have the right leadership to realize the upside. Regarding the Shell partnership, the new COE says continuation of development of cellulosic ethanol could result in growth of the market "from virtually no volume currently to up to 21 billion gallons in the United States alone by 2022."

**Pharma business is strong** – Pharma business alone justifies the current stock valuation. Pharma's revenues of over \$50 million have more than doubled over the last two years. It has customers representing several of the world's largest pharmaceutical companies, including Merck, Pfizer, TEVA and Bristol-Myers Squibb. Drug companies are adopting Codexis enzymes into their manufacturing processes in order to raise their efficiencies, lower their risks, and decrease costs. An impressive example is the use of these enzymes in a new manufacturing process for Januvia, Merck's first-in-class medication for the treatment of Type II diabetes.

**Strong upside in other businesses** – Again, the strong partnerships and customers for Codexis' other businesses indicate substantial market potential down the line. Today, CDXS products are not manufactured on a commercial scale because the economics can't compete with existing petroleum-based fuels and chemicals. However, it's a strong bet that Codexis products, especially with the support of the Company's market-leading partners and customers, will be competitive with traditional petroleum. Customers' continuing demand for an environmentally friendly manufacturing process will continue to drive this trend.

**Risk** – Management is confident Shell will renew its agreement to fund much of the research and development required to commercialize Codexis' CodeXyme cellulose enzymes in the fuels market. Any hiccup in this agreement could further hurt the stock, although much of this uncertainty is already reflected in the shares. The CEO is confident the partnership will continue as it is more than halfway completed and the companies are already discussing market development.

### VALUATION:

Investors' inability to look into the future undermines the current price of this stock. The stock is trading near its yearly low despite having one strong business currently generating impressive results and two other businesses with substantial upside. The company has \$64 million in cash and equivalents, zero debt and a cash burn rate of about \$10 million annually.

#### Codexis, Inc. (NASDAQ:CDXS) Investment Data (as of 7/29/12)

<b>Recent Price</b>	<b>\$3.23</b>
52-Week Range	\$2.96 - \$9.20
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	36 M
Average Trading Volume (3 mos)	170 K
Market Capitalization	\$117 M
Cash	\$53 M
Long Term Debt	0
Enterprise Value (EV)	\$64 M
Book Value	\$2.67
TTM Revenue	\$124 M
P/ Revenue	1x
TTM EPS	(\$0.57)
P/ EPS	NA
TTM EBITDA	(\$6.7M)
EV/ EBITDA	NA

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## Best Idea Profile:

### DESCRIPTION:

Silicon Motion is a fabless semiconductor leader in NAND flash controllers and mobile RF ICx. It designs, develops and supplies multimedia data processing, storage and transfer solutions primarily for the OEMs of consumer electronics applications. The company was established in 1995 in San Jose, California, and is now headquartered in Taiwan. The company went public in 2005 and currently has 670 employees, 77% of whom are engineers.

Mobile storage products, such as card and USB flash drives and SSD and embedded memory, represent 67% of revenues. Mobile communication products make up 25% and multimedia SoCs, such as embedded graphics processors for personal computers and game consoles, is 6%. Revenues in 2011 of \$224 million were up 69% year over year.

### KEY INVESTMENT CONSIDERATIONS:

**New growth markets leading the charge**—Silicon Motion is the reaping rewards from years of developing new products to sustain longer-term expansion, as the growth of core products show some sign of deceleration from their torrid pace. These “new growth products” leverage the underlying leading edge NAND flash controller technology and mobile transceiver technology the Company developed for their core products. Consequently, in the second quarter just reported, new growth products grew by a strong 75% sequentially and accounted for 32% of revenue, compared with only 20% of revenue in the previous quarter. This was way above target for the end of 2012, causing the company to raise its goal. The company now targets roughly 40 to 45% of revenue for these growth products next year.

**Expansion of global smartphone use** — Silicon Motion is highly levered to smartphone growth. It is the number one supplier of controllers for memory cards and is beginning to supply controllers for embedded memory. All solid state storage devices need a controller. Smartphone use is expected to grow 34% per year and the company is creating its own momentum within this market.

## Silicon Motion Technology Corp. (NASDAQ:SIMO)

**4G LTE opportunity** — The compound annual growth rate for the LTE market is forecast to be 113%. Silicon Motion has already had 11 design wins in 2012 with a strong hold on Samsung LTE devices that use its RTx. A link to market-leading consumer products is critical to future success.

**Consistent growth**—The company just released its tenth consecutive quarter of year-over-year growth in revenue. It has consistently beaten estimates, providing good visibility for investors.

### VALUATION:

Silicon Motion released second quarter earnings on July 27 that were better than expected in both revenue and earnings per share. There has been some concern about industry weakness affecting the Company's core businesses. The Company expects this to pick up, as well as to have less impact as its new-growth businesses become a larger percentage of the total. With great growth momentum and consistent outperformance of estimates, the stock should continue higher.

### Silicon Motion Technology Corp. (NASDAQ:SIMO)

Investment Data (as of 7/29/12)

<b>Recent Price</b>	<b>\$15.33</b>
52-Week Range	\$8.27 - \$24.98
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	8 M
Average Trading Volume (3 mos)	623 K
Market Capitalization	\$124 M
Cash	\$114 M
Long Term Debt	0
Enterprise Value (EV)	\$10.6 M
Book Value	\$28
TTM Revenue	\$261 M
P/ Revenue	1.8x
TTM EPS	\$1.65
P/ EPS	9x
TTM EBITDA	\$59 M
EV/ EBITDA	.18

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## Best Idea Profile:

Franklin Covey Co. (NYSE:FC)

### DESCRIPTION:

Franklin Covey is the leading skills training Company serving 75 percent of Fortune 500 companies. It also works with government-related clients, such as the U.S. Navy and state governments, and educational organizations from K-6 schools in the U.S. to schools in India. It provides specialized content, methodologies and tools to help organizations achieve and sustain superior operational and financial performance. It produces measurable and systematic results in areas including leadership, trust, productivity, sales performance and customer loyalty. Each of its seven practices is growing and so are the sales channels. Franklin Covey's billion dollar brands include "The 7 Habits of Highly Effective People," "The 4 Disciplines of Execution" and "The Speed of Trust."

Franklin Covey is based in Salt Lake City and employs 600 people.

### KEY INVESTMENT CONSIDERATIONS:

**Accelerating pipeline** – The prospective business pipeline in the third quarter again exceeded that of the previous year's quarter. This indicates accelerating momentum and good revenue visibility. Over its history, Franklin Covey has worked with 90 percent of the Fortune 100 and thousands of small and mid-sized businesses, numerous government entities and educational institutions. However, the infrastructure is in place to support a much larger business with only minimal incremental costs.

**Recurring revenue** – Recurring revenue was 62% in fiscal 2011, compared with 53% in fiscal 2010. The company's goal is 75%. And penetration within the client base is accelerating. Revenue per client increased nearly 10% in the first half of fiscal 2012. Approximately 70% of the business is delivered electronically.

**Geographic expansion** – The Company increased international royalties by more than a third in fiscal 2011 and is on target to exceed that in 2012. The international licensee business has grown significantly and consistently over the past seven years. Much of the international growth reflects continued penetration in India, China, Singapore, and other emerging markets and is likely to continue through expansion in secondary markets, addition to the sales force and new content. Content is translated and delivered in 40 languages and in more than 140 countries and territories

**Expanding EBITDA margin** – Incremental sales growth has a significant impact on EBITDA and free cash flow. At 13% in fiscal 2011, EBITDA as a percent of revenues was three percentage points higher than the previous year. In the recently reported quarter, adjusted EBITDA margin was the "strongest third quarter ever," causing the company to revise its full-year EBITDA guidance upward.

**Success in fragmented industry** – One industry survey measured the U.S. training industry growth at 13% in 2010 with mostly small competitors. The self-help and training industry holds few barriers to entry. However, it is difficult for competitors to overcome the momentum and brand awareness of Franklin Covey. Its clients claim transformative results that impact sales, margins and retention. The company invests about 4% of revenue on content development annually, which is considerably more than its competitors.

### VALUATION:

**Stock repurchase support** – Franklin Covey recently implemented a stock repurchase plan and started buying the stock in late July. The stock has shown good momentum since then. The July 16<sup>th</sup> death of the guru author and inspiration for much of the company's content, Stephen R. Covey, should not impact performance of the company.

#### Franklin Covey Co. (NYSE:FC)

Investment Data (as of 7/27/12)

<b>Recent Price</b>	<b>\$10.27</b>
52-Week Range	\$6.25 - \$11.73
Fiscal Year End	August
Dividend	NA
Yield	NA
Shares Outstanding	17.8M
Average Trading Volume (3 mos)	39k
Market Capitalization	\$183 M
Cash	\$6M
Long Term Debt	\$33M
Enterprise Value (EV)	\$210M
Book Value Per Share	\$4.90
TTM Revenue	\$164M
P/ Revenue	1x
TTM EPS	\$0.40
P/ EPS	26x
TTM EBITDA	\$19M
EV/ EBITDA	11

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