

# Mossberg's Investor Digest

January 2016

Issue #91

## From the Editor...

Thank you for your subscription to Mossberg's Investor Digest.

**Dycom's Industries (NYSE: DY)** 12,100 employees in 50 states and Canada work hard to deploy the fiber optic cables and communications network infrastructure so that we can all enjoy the pleasure (and possible shame), of binge watching "Game of Thrones" in eight-hour intervals and not have to endure the inconvenience of waiting more than 5-10 seconds for each new episode to buffer enough to begin playing.

Through organic growth and a series of acquisitions since its founding in 1969, Dycom has become the leading contractor installing fiber and infrastructure telecom and cable companies in the United States and Canada.

Given the recent weakness and uncertainty in the stock market and economy, it is not easy to find a Company, like Dycom, whose success should, more or less, be independent of the price of oil (low oil actually lowers cost for operating vehicles and equipment), the Chinese economy, a strong dollar, Fed policy failures or an economic recession. Instead, Dycom's success is dependent upon executing on the opportunity to help service providers deploy the infrastructure necessary to support accelerating growth in IP traffic.

We believe the company should be able to command an EV/EBITDA multiple of 8x or higher. This is in line with comparables PRIM and MTZ. Applied to our rough estimate of \$560 million in EBITA in the next three years, yields a valuation that would be double the current price over the same time period.

As always, I appreciate your feedback.

Dave Mossberg  
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## January 2016 Issue

Every month we hear ideas suggested from our large network of professional investors. Here are a few of the ideas we heard this month, but have not reviewed in detail...

**First Cash Financial Services (Nasdaq: FCFS)**- First Cash Financial Services, Inc. is a leading operator of retail pawn stores serving cash-constrained customers. Primary products include Consumer electronics, appliances, jewelry, power tools, musical instruments and sporting goods. The company owns 1,250 pawn and consumer loan stores in the U.S. (48% of revenue) and Latin America. (52% of revenue). The company recently initiated a cash dividend

**IMAX (NYSE: IMAX)** - IMAX Corporation is a diversified motion picture technology company. There are 1,008 IMAX theatres in 66 countries that utilize the IMAX immersive projection technology, which are operated by the company or in partnership. In total, the company operates in seven segments: IMAX Systems, Theater System Maintenance, Joint Revenue Sharing Arrangements, Film Production and IMAX Digital Re-Mastering (DMR), Film Distribution, Film Post-Production, and Other.

**Cash America International (NYSE: CSH)** - Cash America International is a leading operator of retail pawn stores serving cash-constrained customers. The company has a total of 825 locations in 20 U.S. states. In terms of loan to customers, it is the largest pawn lender in the U.S. The Company has recently exited its consumer lending business and is focused on pawn operations.

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## Mossberg's Investor Digest Idea Performance

The table below shows the relative change in the value of the ideas published since March 2015 and the Russell 2000. **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 2000 Change Since Pub.	Relative Perf. vs. Russell 2000	
M/A-Com Technology Solutions Holdings, Inc. (NASDAQ:MTSI)	28-Mar-15	\$35.81	\$39.77	11.1%	-19.2%	30.2%	
Kimball International, Inc. (NASDAQ:KBAL)	30-Apr-15	\$9.97	\$9.59	-3.8%	-17.8%	14.0%	
Ironclad Performance Wear Corp. (OTC:ICPW)	30-May-15	\$0.27	\$0.28	1.9%	-19.6%	21.4%	
Customers Bancorp, Inc. (NYSE: CUBI)	30-Jun-15	\$26.87	\$24.84	-7.6%	-20.0%	12.5%	
Potbelly Corporation (NASDAQ: PBPB)	30-Jul-15	\$13.43	\$10.51	-21.7%	-18.6%	-3.1%	
Cosi Inc. (NASDAQ:COSI)	31-Aug-15	\$1.17	\$0.63	-46.2%	-13.5%	-32.6%	
Calloway Golf Company (NYSE: ELY).	30-Sep-15	\$8.39	\$8.56	2.0%	-8.9%	10.9%	
New Gold (NYSE: NGD).	31-Oct-15	\$2.47	\$2.43	-1.6%	-13.7%	12.1%	
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$9.11	-20.3%	-16.3%	-4.0%	
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$12.45	6.2%	-11.7%	17.9%	
				<b>Average</b>	<b>-8.0%</b>	<b>-15.9%</b>	<b>7.9%</b>

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Best Idea Profile:

Dycom Industries, Inc. (NYSE: DY)

## DESCRIPTION:

Dycom's Industries' 12,100 employees in 50 states and Canada work hard to deploy the fiber optic cables and communications network infrastructure so that we can all enjoy the pleasure (and possible shame), of binge watching "Game of Thrones" in eight-hour intervals and not have to endure the inconvenience of waiting more than 5-10 seconds for each new episode to buffer enough to begin playing.

Through organic growth and a series of acquisitions since its founding in 1969, Dycom has become the leading contractor installing fiber and infrastructure telecom and cable companies in the United States and Canada. As you might expect, top customers include:

AT&T - 19.1% of revenue

CenturyLink - 15.6% of revenue

Comcast -12% of revenue

Verizon - 9.7% of revenue

"Unnamed Customer" - 8.5% of revenue (this is most likely Google)

Windstream - 6.7% of revenue

Time Warner - 4.9% of revenue

Approximately 90% of the company's revenue is derived from contracting services related to Telecommunications industries. Services include designing and deploying above and below ground fiber optic, copper and coaxial cable from service providers central office to customers' premise and all of the associated activities including: obtaining rights of way and permits, excavating trenches, placing poles, manholes, cabinets, etc. Services also include tower construction, antenna installation, and foundation and equipment pad construction for wireless carriers. The remaining 10% of revenue is related to locating underground cables and facility and other contract services for electric and gas utilities.

## Dycom Industries, Inc (NYSE: DY)

Investment Data (as of 1/29/16)

<b>Recent Price</b>	<b>\$62.18</b>
52-Week Range	\$30.66 - \$90.82
Fiscal Year End	July
Dividend	N/A
Yield	N/A
Shares Outstanding	32.5 M
Average Trading Volume (3 mos)	150 k
Market Capitalization	\$2.1 B
Cash	\$22 M
Long-term Debt	\$642 M
Enterprise Value (EV)	\$2.6 B
Book Value	\$16.75
P/ Book	3.7 x
TTM Revenue	\$2.2 B
EV/ Revenue	1.2 x
FY16(July) EPS (consensus)	\$3.92
P/ EPS	15.9x
FY16(July) EBITDA (est.)	\$370 M
EV/ EBITDA	7.0x

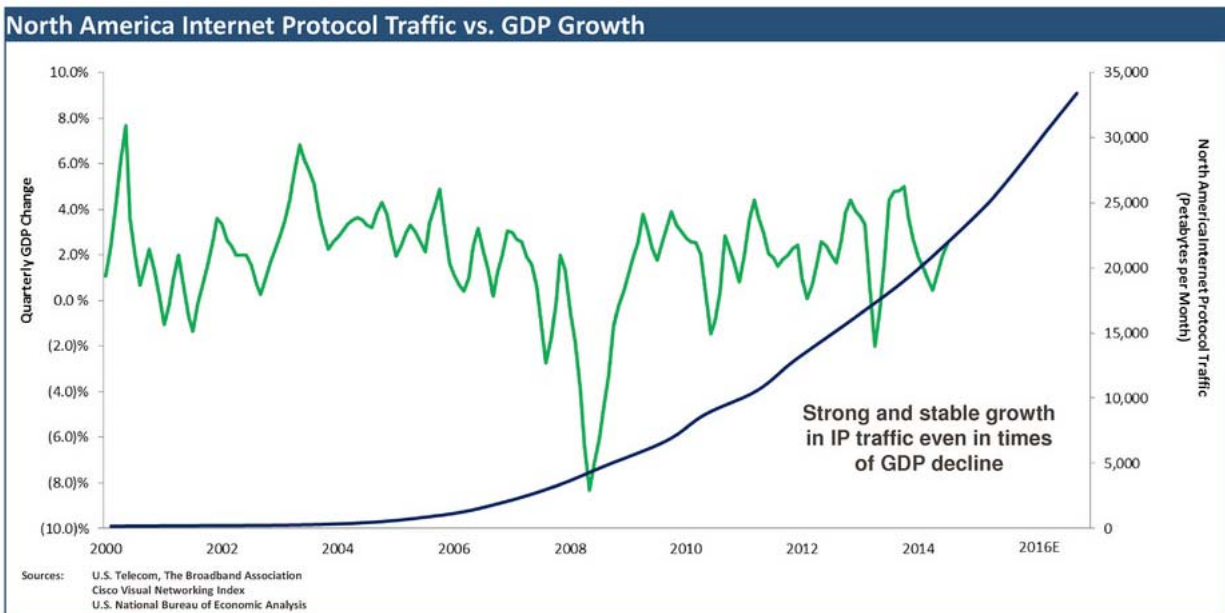
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## KEY INVESTMENT CONSIDERATIONS:

**Growth of IP Traffic...the "Zettabyte Era"** - According to Cisco, it took 32 years to generate the first zettabyte of annual IP traffic, a milestone we reached just this past year. IP annual traffic is expected to reach the next zettabyte in annual traffic 3 years from now, one tenth the amount of time to reach the first. For perspective, a zettabyte in numerical terms is 1,000,000,000,000,000,000 bytes, or a "1" with 21 zeroes. In more practical terms, a zettabyte of annual traffic is the equivalent of 250 billion DVD's, or every person on earth binge watching 8-hours of "Game of Thrones" on Netflix every month for a year.



**Success independent of near term economic risks** - Given the recent weakness and uncertainty in the stock market and economy, it is not easy to find a Company, like Dycom, whose success should, more or less, be independent of the following uncertainties:

- The price of oil (low oil actually lowers cost for operating vehicles and equipment)
- The Chinese economy
- A strong dollar
- Fed policy failures
- An economic recession

Instead, Dycom's success is dependent on the need to deploy the infrastructure necessary to support the following trends that are likely to continue with a high level of certainty:

- More people watching internet TV on demand
- Cloud computing
- More devices being connected to the internet
- Proliferation of smartphones and tablets
- Growth in social media
- Global positioning functionality and location based services

Reinforcing this thesis, as the chart above shows, historically there has been zero correlation between the growth in internet traffic and GDP. Of course, Dycom does have to execute on its opportunities. However, given the relative scale and scope of its footprint and services, there is little reason why Dycom won't continue to be the vendor or choice to deploy the networks necessary to support these trends.

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## KEY INVESTMENT CONSIDERATIONS: (Continued)

**Massive multi-year spend on wireline network infrastructure to support growth** – Dycom is well positioned to be the beneficiary of a multi-year investment in network infrastructure.

- **Fiber to business and curb** – Service providers are increasingly deploying fiber optic cable technology closer to consumers and businesses. At the end of 2015 about 34 million homes in the U.S. were capable of offering fiber services and 12.3 million have actually connected. These numbers are expected to grow substantially over the next several years. AT&T alone has committed to deploying 12.5 million homes in the next four years.
- **New Entrants are forcing incumbents to spend to remain competitive** – Increased spending is also being driven by increased competition among traditional competitors (AT&T/ Verizon), but more importantly from new entrants like Google (which is likely DY's unnamed customer). Since 2012, Google has introduced fiber optic services in 18 metro areas. Customers can get 1G internet up and down plus TV for \$130 per month. Municipal governments and other companies are beginning to copy Google's playbook to offer similar services, which will compete with the incumbents.
- **Connect America Fund** – The Connect America Fund is a six year program, administered by the FCC, which will provide \$1.7 billion in funding per year to incentivize carriers and other to expand broadband service into rural areas.
- **Spending on services represents 70%+ of the spend to deploy these networks** - It is important to note spending on services to deploy these networks will far will outpace the spending on equipment. For every \$1 spent to deploy a new network, 70 cents goes to pay for deploying it... only 30 cents go to pay for the equipment.

### Attractive attributes of the business model

- **Economies of scale** - Dycom is a market leader in a fragmented market. As such it competes well for business with large national service providers that prefer vendors with a national foot print and greater financial resources. Larger competitors include MasTec, UniTek Global Services and Goodman Networks, all of which tend to have less focus on wireline communications. Dycom's approach to operations is to centralize back office work such as finance and IT so that it can gain efficiencies of scale. Other customer-facing functions such as marketing, field operations, are decentralized, which promotes greater accountability, faster decision processes and improved customer satisfaction. As such Dycom is the parent company for 44 separate regional companies, which is why it's not a well-known name.
- **90% of revenue from Master Service Agreement and Long-term contracts provide a stable base of revenue** – Multi-year master service agreements comprise approximately 65% of the company's sales and long-term contracts for specific projects comprise another 15%.
- **Sizable backlog increases visibility** - Backlog at the end of the first quarter was \$4 billion, of which \$1.6 billion is expected to be completed in the next 12 months. While it's difficult to infer revenue trends on a quarterly basis from backlog, having such a larger backlog number relative to the trailing twelve months revenue (\$2.2 billion), should give investors greater confidence in annual trends.

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## Valuation

**Management has been good stewards of equity capital** – Management and the board have been actively acquiring shares over the past two years. In fiscal 2015, the company repurchased 1.7 million average price of \$52.19. Thus far in FY16, they have repurchased 1 million shares at \$73.35. Combined the company has spent \$160 million to repurchase approximately 5% of its outstanding shares.

### Back of the Envelope Assumptions:

- **Revenue Growth:** Given the significant increase in network spending, we assume a 12% top line growth rate for the next three years.
- **Profitability:** We assume profitability to improve slightly as the company should be able to retain pricing power and increases in healthcare costs should be more than offset by lower fuel costs and efficiencies of scale. In the calculation we assume a 100 basis point improvement in EBITDA margins.
- **Cash Flow Generation:** We assume the company will be able to generate \$50 million in free cash flow for each of the next three years.
- **Valuation multiple:** We believe the company should be able to command an EV/EBITDA multiple of 8 or higher in the next three years given its consistent track record and growth prospects. This is in line with comparables MTZ and PRIM and when applied to the potential EBITDA would yield a valuation in three years that is double current prices.

Revenue	2,500,000,000	3,512,320,000
EBITDA %	15%	16%
EBITDA	370,000,000	561,971,200
EV/ EBITDA	7	8
Enterprise Value	2,600,000,000	4,495,769,600
Debt		640,000,000
Cash		22,000,000
Cumulative Free Cash Flow		150,000,000
Market Capitalization		4,027,769,600
Shares Outstanding		33,400,000
Price per share		\$121

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The value proposition of the digest is essentially an "Idea Generator". During the course of my 18-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 briefly describe the most relevant investment merits and risks of a company. It is not intended to be an exhaustive report including every detail. 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.

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