

# Mossberg's Investor Digest

June 2015

Issue #84

## From the Editor...

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

This month's issue features, Customer Bancorp, a rapidly-growing bank holding company that has expanded both its asset and equity base by more than 20-fold since it was founded in the 2009. The Company has an "asset-light" business model designed to serve a large number of both business and retail customers without using a large network of branch locations. With just 18 sales offices, its principal subsidiary, Customers Bank, services business customers in the North East from Boston to Philadelphia and has grown to an asset base of \$7.1 billion. CUBI launched BankMobile at the beginning of 2015, a virtual bank that will use mobile devices to provide banking services. The Company expects BankMobile to have 25,000 customers in the first year, and 250,000 over a five-year period. Comparatively, other fast growing banks such as SBNY and FRC are trading at more than 2x book and 17x to 18x earnings. Applying these multiples to CUBI's 2016 estimates yields a valuation of \$38 to \$40 per share, which implies 40% to 50% upside from current levels. This assessment applies no value to BankMobile, which has the opportunity to add significant incremental value to shareholders.

As always, I appreciate your feedback.

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## June 2015 Issue

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

**Lannett Company, Inc. (NYSE: LCI)** - Lannett develops, manufactures and distributes generic prescription pharmaceutical products throughout the United States. Lannett markets its products primarily to drug wholesalers, retail drug chains, distributors, and government agencies. Lannett has grown substantially, with a top line compounded annual growth rate of more than 25% since 2001. The company intends to grow its business organically, as well as by acquiring complementary products or companies and forming strategic relationships.

**Radiant Logistics, Inc. (NYSE MKT: RLGT)**- Radiant Logistics is operating as a non-asset based third party logistics provider and one of the fastest growing logistics networks in North America. Radiant's network now extends to over 100 Stations across North America, serving a diversified account base including manufacturers, distributors and retailers using a network of independent carriers and international agents positioned strategically around the world.

**Energy Recovery, Inc. (NASDAQ: ERII)** - Energy Recovery is a global leader in transforming untapped energy into reusable energy in fluid flow applications. Energy Recovery enables the harnessing of energy from industrial fluid flows using their proprietary energy recovery technologies, thus allowing their customers to reduce operating costs and increase profitability while minimizing their environmental impact and carbon footprint.

**Good Times Restaurants Inc. (NASDAQ: GTIM)**- Good Times Restaurants operates Good Times Burgers & Frozen Custard, a regional chain of quick service restaurants located primarily in Colorado, in its wholly owned subsidiary, Good Times provides a menu of high quality all natural hamburgers, 100% all natural chicken tenderloins, fresh frozen custard, fresh cut fries, fresh lemonades and other unique offerings. Good Times currently operates and franchises 38 restaurants. 27 company owned stores and 11 franchise locations. The company has performed well showing 5 years of same store sales growth.

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## Best Idea Profile:

Customers Bancorp, Inc. (NYSE: CUBI)

### DESCRIPTION:

Headquartered in Reading, PA, Customer Bancorp is a rapidly-growing bank holding company that has expanded both its asset and equity base by more than 20-fold since it was founded in the 2009 through the acquisition of New Century Bank. The bank has \$7.1 billion in assets and \$458 (\$16.94 per share) in equity, up from \$350 million in assets and \$22 million in equity (\$8.78 per share), respectively, in 2009.

The Company has an "asset-light" business model designed to serve a large number of both business and retail customers without using a large network of branch locations. With just 18 sales offices, its principal subsidiary, Customers Bank, services business customers in the North East from Boston to Philadelphia. Customers Bank, which comprises almost all of current revenue, also makes loans to mortgage banking companies nationally. To serve retail customers, CUBI launched BankMobile at the beginning of 2015, a virtual bank that will use mobile devices to provide banking services. The Company expects BankMobile to have 25,000 customers in the first year, and 250,000 over a five-year period.

Customers Bancorp generates revenue from commercial (93% of loan portfolio) and consumer lending (7% of loan portfolio). Commercial lending is divided into four groups:

- 1) **Multi-family** – (35% of total loan portfolio) – CUBI focus on high-net worth families in their primary markets of New York and Philadelphia that have income producing real estate.
- 2) **Mortgage company loans** – (28% of loan portfolio) – CUBI provides short-term financing to mortgage bankers to finance residential mortgage originations from loan closing until sale in the secondary market. This market has an attractive risk/reward profile with attractive spreads and limited credit risk, as the majority of the underlying loans are secured by mortgages backed by U.S. Government agencies (Fannie Mae, Freddie Mac, FHA and VA).
- 3) **Owner/non-owner occupied commercial real estate** (21%, and 9% of loan portfolio, respectively) – CUBI makes loans to businesses primarily secured by real estate in its primary markets.

### Customers Bancorp, Inc. (NYSE: CUBI)

Investment Data (as of 6/29/15)

<b>Recent Price</b>	<b>\$26.87</b>
52-Week Range	\$17.10 - \$28.00
Fiscal Year End	December
Dividend	N/A
Yield	-
Shares Outstanding	26.8 M
Average Trading Volume (3 mos)	130 k
Market Capitalization	\$750 M
Cash	\$343 M
Long-term Debt	1.76 B
Enterprise Value (EV)	\$2.2 B
Book Value	\$17.07
P/ Book	1.6 x
TTM Revenue	\$179 M
P/ Revenue	4 x
FY15 EPS (consensus)	\$1.99
P/ EPS	13.5x
TTM EBITDA	\$97 M
EV/ EBITDA	23x

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## KEY INVESTMENT CONSIDERATIONS:

**“Getting the band back together for a repeat performance”** – At 63 years old, CEO Jay Sidhu has had an impressive career in banking. From 1989 till 2006, he led Sovereign Bank from its \$12 million IPO to eventually become the 17<sup>th</sup> largest bank in the U.S. with a market cap of \$12 billion. He has received numerous accolades including Financial World’s CEO of the year and Turnaround Entrepreneur of the year. Since founding Customers Bancorp, Mr. Sidhu has been assembling a team of highly experienced and successful executives with an average of 30+ years of banking experience. Many of the senior executives share a common tenure at Sovereign bank, including President & COO, Richard Ehst; and at least a half dozen other senior officers of the firm.

**How to grow and create shareholder value in a commodity business** – Both commercial and retail banking have antiquated business models that offer nearly indistinguishable commoditized service. Despite the lack of efficiencies of scale and scope, which typically are advantages in mature industries, CUBI has already demonstrated with its 40% CAGR that it has the ability to take market share from slow-moving and asset-laden incumbent players. Because of the following factors, we believe CUBI will continue to grow at rates above market average.

- **Be the low cost producer** – In an undifferentiated commodity service, usually the lowest price wins. To keep up with competitive pricing pressures, lower cost and greater efficiencies are probably the most important factors to survival and success. The primary factors that drive costs in banks are:
  - 1) Operating efficiencies – Based on nearly every operating efficiency measure, CUBI outperforms the industry and peers. For example, the total revenue per employee is \$479,000, versus a peer average of \$255,000. Also its staff expense ratio is 84 basis points, versus 1.7 percentage points and 1.4 percentage points for the industry and its peer group, respectively. Efficiencies come from luring quality talent and retaining them by rewarding well for contribution, focusing on the right business, and maintaining a limited amount of branch locations.
  - 2) The ability to attract depositors - Since deposits are the lowest cost form of capital for a bank, the more a bank can attract, the more it can earn on its interest rate spread. CUBI has grown its deposits per branch by a 44% 5-year CAGR to \$243 million, one of the highest in the industry.
  - 3) Actual and perceived rate of charge offs (bad loans) - Finally, CUBI has lowered its hard costs of charge offs, as well as its cost of borrowing and equity capital by having a quality asset portfolio. CUBI’s charge off percentage was 7 basis points during 2014, versus 22 basis points for the industry and 14 basis points for its peer average.
- **Differentiate** – In a commodity market, offering differentiated services is often very difficult, as it usually involves greater costs to provide an elevated service level, which limits the addressable market to less price sensitive customers. Through the use of technology and a high touch “concierge banking” strategy, CUBI has been able differentiate its service offering, while at the same time actually lowering its costs. One key to their success has been to attract and retain quality loan officers with approximately 15 years+ experience that can bring in their own book of business. Another key for CUBI has been to provide relationship managers, or private bankers, that act as a single point of contact for all of the customer’s commercial needs and create enduring relationships. As a result, CUBI does not do advertising and relies on customer referrals to drive growth. By creating trusted relationships, the concierge model also reduces the need to have a branch in every market to drive growth. For example, CUBI has generated \$500 million in new loans from the Boston/ Providence area, without having a branch location.

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## KEY INVESTMENT CONSIDERATIONS: (continued)

**The Amazon/ Uber/ Netflix of banking is coming** – Just as these companies are icons for using technology to disrupt entrenched industries, there is an opportunity for a few companies that are introducing mobile banking platforms to become dominant players in disrupting the retail banking industry. CUBI has a good shot at being one of those dominant players.

- **People hate their banks** - Bundling services is a tactic that banks have used to delay the commoditization. For example, customers are less likely to switch banks due to the difficulty of changing out bundled financial services such as on-line bill payment, mortgages and/or loans. However, there is a threshold of incremental fees and/or poor service that will drive customers to consider switching. Much like people hated Blockbuster for charging past due fees, and retail stores for being out of stock, retail banking customers don't like paying fees just so they can support a branch location that they only set foot in one time per year. Customers are increasingly willing to trust the new mobile banking platform, and likewise their willingness to switch is increasing. According to Accenture's 2014 digital banking survey, more than one in four respondents (four in ten from ages 18-24) would consider switching to a branchless digital bank.
- **Traditional branch-based banks won't be able to compete** –With the costs of physical branch network to support, traditional banks rely on fees to support the costs of bricks and mortar and staff at each location. According to Reuters, branch-based transactions cost 50 times as much as the same transaction conducted over a mobile phone. In order to make customers profitable, banks charge customers \$32 billion annually in overdraft fees and \$8 billion annually on ATM fees. As such, traditional banks won't be able to cost effectively compete against new entrants that do not have the cost of branch networks to support and can charge much less to make customers profitable. In addition, these banks have 20-, 30- and even 40-year old IT systems that don't mesh well with a latest model iPhone.
- **Enter BankMobile** – As a branchless bank, CUBI launched BankMobile at the beginning of this year with an intent to get consumers to like their bank again. As such BankMobile customers will not be charged any ATM fees for using more than 55,000 ATMs and no overdraft fees. Customers will be offered interest bearing lines of credit that allow them to borrow funds when withdrawals exceed deposits temporarily, and offered 25 bps higher interest rates on savings accounts. Without fees, BankMobile's business model is supported by the fees divided between a bank and a credit card company on merchant purchases and margins on overdraft loans.
- **Attractive returns expected** – CUBI plans to invest no more than \$6 million by the end of 2015 and expects to grow to 25,000 accounts by the end of 2015 and 250,000 accounts and above average ROE within 5 years. That is the equivalent of adding about 136 accounts per day for the next five years, a feat that management commented would require a traditional bank to have 350 branch locations. Instead of traditional advertising, the growth of BankMobile will be supported by social media marketing and marketing to affinity groups.

**Buy the business bank, get the mobile bank for free** – Comparatively, other fast growing banks such as SBNY and FRC are trading at more than 2x book and 17x to 18x earnings. Applying these multiples to CUBI's 2016 estimates yields a valuation of \$38 to \$40 per share, which implies 40 to 50% upside from current levels. This assessment applies no value to BankMobile, which has the opportunity to add significant incremental value to shareholders.

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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 September 2014 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	
Helen of Troy (NASDAQ:HELE)	15-Sep-14	\$54.62	\$96.80	77.2%	4.5%	71.4%	
SMTP, Inc. (NASDAQ:SMTP)	16-Sep-14	\$6.26	\$5.96	-4.8%	3.8%	-10.0%	
Mandalay Digital Group, Inc. (NASDAQ:APPS)	24-Sep-14	\$4.92	\$3.08	-37.4%	4.2%	-42.6%	
L.B. Foster Company (NASDAQ:FSTR)	30-Sep-14	\$45.94	\$34.80	-24.2%	5.7%	-30.8%	
Chart Industries, Inc. (NASDAQ:GTLS)	13-Oct-14	\$42.06	\$35.21	-16.3%	11.4%	-28.2%	
MRI Interventions, Inc. (OTC BB: MRIC)	16-Oct-14	\$1.08	\$1.10	1.5%	11.5%	-11.1%	
Franklin Electric Co., Inc. (NASDAQ:FELE)	23-Oct-14	\$36.71	\$32.30	-12.0%	6.6%	-20.0%	
Avigilon Corporation (TSX:AVO.TO)	29-Oct-14	\$15.30	\$16.93	10.7%	4.8%	4.4%	
Chemtura Corporation (NYSE:CHMT)	6-Nov-14	\$23.38	\$28.05	20.0%	2.4%	16.6%	
Hilltop Holdings Inc. (NYSE:HTH)	11-Nov-14	\$21.14	\$23.95	13.3%	2.0%	10.3%	
Bravo Brio Restaurant Group, Inc. (NASDAQgs:BBRG)	24-Nov-14	\$13.15	\$13.46	2.4%	0.5%	0.8%	
Alamo Group (NYSE: ALG)	26-Nov-14	\$48.83	\$54.40	11.4%	0.4%	10.0%	
PGT, Inc. (NASDAQ:PGTI)	12-Dec-14	\$9.00	\$14.57	61.9%	4.0%	57.0%	
Unilife Corporation (NASDAQ:UNIS)	15-Dec-14	\$2.72	\$2.14	-21.3%	4.7%	-26.9%	
The Dixie Group, Inc. (NASDAQ:DXYN)	19-Dec-14	\$9.21	\$10.42	13.1%	0.5%	11.6%	
Points International Ltd. (NASDAQ:PCOM)	20-Dec-14	\$12.86	\$12.34	-4.0%	0.5%	-5.6%	
Cascade Microtech Inc. (NASDAQ:CSCD)	19-Jan-15	\$14.02	\$15.21	8.5%	2.8%	4.8%	
Quanex Building Products Corporation (NYSE:NX)	20-Jan-15	\$18.53	\$21.42	15.6%	2.8%	11.9%	
Ballantyne Strong, Inc. (NYSE:BTN)	27-Jan-15	\$4.15	\$4.66	12.3%	2.0%	8.3%	
InfuSystem Holdings, Inc. (NYSE:INFU)	29-Jan-15	\$2.71	\$3.21	18.5%	2.5%	14.8%	
EXO U Inc. (EXO.V)	23-Feb-15	\$1.65	\$0.80	-51.5%	-1.8%	-52.6%	
Liquidity Services, Inc. (LQDT)	24-Feb-15	\$9.79	\$9.79	0.0%	-2.1%	0.7%	
Smith & Wesson Holding Corporation (NASDAQ:SWHC)	25-Feb-15	\$12.89	\$16.48	27.9%	-2.0%	28.6%	
Actua Corporation (NASDAQ:ACTA)	26-Feb-15	\$16.47	\$14.37	-12.8%	-1.9%	-12.1%	
M/A-Com Technology Solutions Holdings, Inc. (NASDAQ:MTSI)	28-Mar-15	\$35.81	\$38.20	6.7%	0.0%	4.9%	
Kimball International, Inc. (NASDAQ:KBAL)	30-Apr-15	\$10.38	\$12.18	17.3%	-0.8%	16.5%	
Ironclad Performance Wear Corp. (OTC:ICPW)	30-May-15	\$0.27	\$0.29	7.4%	-1.9%	7.6%	
				<b>Average</b>	<b>5.2%</b>	<b>2.5%</b>	<b>1.5%</b>

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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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\*As of June 2015, the publisher owns shares in DSNY.

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