

# Mossberg's Investor Digest

October 2015

## From the Editor...

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

This month's issue features, **New Gold (NYSE: NGD)**. New Gold produces about 400,000 ounces of gold each year from its mines in Canada, the United States, Australia and Mexico. In addition, the Company also produces Copper (~100 million lbs) and Silver (~1.5 million oz) as by-products of its gold mining operations. The Company has two 100%-owned large scale development projects in Canada, which are expected to increase gold production levels to 3x the current run rate. The first large scale project is expected to increase annual production by approximately 75%, when it comes on line in mid-2017. The second large scale development project is expected to increase production by another 485,000 annually, but won't begin major development until after the first development project is completed.

Most investors seem to hate Gold stocks right now, as evidenced by the 40% decline in NGD share prices this year. In general, I'm also not a fan of gold mining stocks, but in the letter I explain why NGD has attributes that abate my concerns.

As the companies two large projects come on line, there is significant upside to the valuation of the company. Based on our back of the envelope calculation, we see the potential for 2-4x increase in the next 3-5 years if our assumptions hold true.

As always, I appreciate your feedback.

Dave Mossberg  
[Dave@mossbergid.com](mailto:Dave@mossbergid.com)

## October 2015 Issue

Issue #88

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...

**Ciber, Inc. (NYSE: CBR)** - Ciber, Inc. operates as an information technology (IT) service company worldwide. It operates through two segments, International and North America. The company's application development and maintenance services offer analysis, design, development, testing, implementation, and maintenance of its client's business applications. It also operates as an independent software vendor or channel partner for industry leaders; and provides project management, application and technical consulting, database administration, and infrastructure support for project-based or managed-services.

**Furmanite Corporation (NYSE:FRM)** - Is one of the world's largest specialty industrial services and specialty engineering project solutions companies, providing world class solutions to customer needs through more than 85 offices on six continents. The Company delivers an integrated portfolio of engineering, inspection and specialty mechanical services which, grouped together, provide a comprehensive Asset Life Cycle Solution for global energy, industrial and municipal infrastructures.

**Sigma Designs, Inc. (Nasdaq: SIGM)** - Is a leading provider of system-on-chip (SoC) solutions used to enable the convergence of the smart home. Few companies have more experience than Sigma in delivering the technologies that drive new markets. Sigma is in the ideal position to capitalize on the critical trends that are driving new product adoption and sales in the smart home from 4K to HEVC compression that allows service providers to maximize their delivery channels. In the rapidly growing IoT for the home space, Sigma's Z-Wave technology is the industry leader because of its unrivaled portfolio of interoperable products.

**Senomyx Inc. (Nasdaq: SNMX)** - Senomyx, Inc. discovers, develops, and commercializes flavor ingredients for the packaged food, beverage, and ingredient supply industries using proprietary taste receptor-based assays and screening technologies. The company focuses on the discovery, development, and/or commercialization of flavor ingredients through five programs focused on sweet, savory, bitter, cooling, and salt taste areas. It licenses flavor ingredients to its collaborators on an exclusive or co-exclusive basis.

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# Mossberg's Investor Digest

Best Idea Profile:

New Gold, Inc. (NYSE: NGD)

## DESCRIPTION:

New Gold produces about 400,000 ounces of gold each year from its mines in Canada, the United States, Australia and Mexico. In addition, the Company also produces Copper (~100 million lbs) and Silver (~1.5 million oz) as by-products of its gold mining operations. The Company has two 100%-owned large scale development projects in Canada, which are expected to increase gold production levels to 3x the current run rate. The first large scale project is expected to increase annual production by approximately 75%, when it comes on line in mid-2017. The second large scale development project is expected to increase production by another 485,000 annually, but won't begin major development until after the first development project is completed.

## New Gold, Inc. (NYSE: NGD)

Investment Data (as of 10/30/15)

<b>Recent Price</b>	<b>\$2.47</b>
52-Week Range	\$1.90 - \$5.12
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	509 M
Average Trading Volume (3 mos)	4.3 M
Market Capitalization	\$1.3 B
Cash	\$327 M
Long-term Debt	\$879M
Enterprise Value (EV)	\$1.9 B
Book Value	\$4.44
P/ Book	0.6 x
TTM Revenue	\$694 M
EV/ Revenue	2.7 x
FY15 EPS (consensus)	(\$0.01)
P/ EPS	N/A
TTM EBITDA	\$240 M
EV/ EBITDA	8.0x

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## KEY INVESTMENT CONSIDERATIONS:

**Why I don't like gold mining stocks, but like New Gold** – Before reviewing the investment merits of New Gold (NYSE: NGD), I should note that I am not a fan of mining stocks in general. This is the third name of 325 ideas I've profiled since starting the newsletter that is a mining company. In an industry that regularly needs to issue equity capital and is susceptible to significant swings in commodity prices, it is very hard to make investments that will allow you to be right more than you are wrong. Here are the three reasons why I'm not a fan of mining stocks and how New Gold has attributes that abate my concerns.

**1) Miners tend to be "serial capital raisers" and often dilute shareholders** – Because they consume large amounts of capital to develop and maintain mines, many mining companies regularly issue equity capital, which in itself is not a bad thing. However, many mining companies depend on the ability to issue equity capital in order to grow and, in some cases, sustain operations. When the market is in correction mode, the effect of the need to raise equity capital to sustain operations can be very dilutive, if not much worse. In the past ten years, the market (as defined by the Russell 2000) has corrected by more than 12% four times... on average it has experienced declines of 18% every 2 ½ years (the average decline excludes the depression of '08/'09). If a mining company's need for equity capital coincides with a market correction, the dilution is likely to be a lot more than the average, as Wall Street is not known to avoid opportunities to exploit companies when there is blood in the water. To illustrate my point, according to one industry study of the ten largest gold mining stocks, the amount of gold production per share declined to 65% of what it was 15 years ago.

**New Gold has been an excellent steward of equity capital** – A great example of NGD's stewardship is the creative way management financed the Rainy River project. Management needed about \$250 million of incremental capital to ensure adequate liquidity for \$880 million in project development costs. To generate the funds, management negotiated a transaction with Royal Gold, which effectively covers 20% (\$175 million) of the total development capital for the Rainy River Project, but only gives up a 6% stake in future estimated revenue from this project, which is capped at certain production thresholds and allows New Gold to maximize its potential upside from greater than expected production or increasing gold prices. Management secured the remaining capital required by selling its 30% stake in El Morro to Goldcorp, and in the process, yielded \$65 million in net cash, eliminated \$93 million in debt, and yet retained a 4% royalty stream in the project. If management had chosen to issue common equity, at the stock price when the deals were announced, the Company likely would have issued shares at \$2.50 or lower, and would have effectively diluted shareholders interest in the entire company by approximately 20%. Instead management negotiated transactions that yielded significantly lower dilution in just certain projects, not the whole company.

# Mossberg's Investor Digest

## KEY INVESTMENT CONSIDERATIONS:

- 2) **Swings in commodity prices make it difficult to deliver consistent returns, manage debt levels, etc.** – During the average two-year prior of the last 10 years, the average fluctuation in the price of gold has been approximately 32%. Allocating capital that requires investment decisions for 10 to 15 year production assets relative to these significant swings in price is challenging for any management team. In order to survive and build shareholder value, a business in this environment must continuously focus on lowering costs and pursue investment in projects that have the lowest production costs.

**New Gold is among the lowest cost producers in the industry**

– New Gold is among the lowest cost producers in the industry with an All In Sustaining Cost (AISC) of \$788 per ounce during the third quarter of 2015. As its name implies, All In Sustaining Costs (AISC) is a measure of the direct cash costs of extracting gold from the ground, as well as indirect sustaining costs including depreciation, exploration and G&A expense. Relative to the \$950/oz. average AISC of the Top 10 gold producers, New Gold has a 16% cost advantage, which should result in above industry margins and greater ability to weather a further decrease in the commodity price. New Gold's costs should be reduced even further when its Rainy River project comes on line in Mid-2017, which represents incremental production growth of 75% at an AISC of \$670 per ounce.

<u>Company</u>	<u>All In Sustaining Costs Per Oz 2015</u>
Oceana Gold	\$708
<b>New Gold*</b>	<b>\$788</b>
Agnico-Eagle Mines	\$850
Barrick Gold	\$875
Goldcorp	\$889
Yamana Gold	\$896
Eldorado Gold	\$975
Newmont Mining	\$990
Anglogold Ashanti	\$1,020
Kinross Gold	\$1,050
Gold Fields	\$1,055

- 3) **When gold is in favor too many dollars chase too few attractive opportunities** - The size of the 30 largest gold stocks is about \$140 Billion, which is less than 1% of the size of the \$18 trillion value of the S&P and \$40 trillion value of the U.S. Bond market. As Gold is often seen as attractive insurance against inflation, or other financial/market volatility, a ½ a point increase in portfolio allocation to gold stocks could equate to a doubling in the size of the capital base for the largest 30 players. Just because there is more capital, doesn't mean there are as equally as many attractive places to invest in gold mines. In fact, despite the massive influx in capital during the peak of the last cycle, the amount of gold production has basically been flat for the past dozen years. Instead of finding projects that resulted in increased production, incremental cash flows into the industry led to higher lease prices and overpriced M&A transactions, making it more difficult to earn decent returns and a significant destruction of shareholder value.

# Mossberg's Investor Digest

## KEY INVESTMENT CONSIDERATIONS:

**Leadership is among the best in the industry** – The leadership team includes some heavy hitters with experience at some of the largest and most successful gold mining companies. In addition, insiders collectively have \$45 million invested in the company, which clearly incentivizes them to make decisions that are aligned with shareholders.

- **Pierre Lassonde** – One of the Company's Director and largest insider shareholder, Pierre Lassonde, clearly stands out in the gold mining industry as an exceptional value creator. Mr. Lassonde founded Franco-Nevada in 1982 and grew that company at a 36% annual rate for 19 years until it was sold in 2002. In 2008, he returned to Franco-Nevada, where he is currently Board Chairman, and oversaw the company's IPO, which at the time, was the largest mining IPO in history. Since coming back to Franco-Nevada its value has grown 3.5x. From 2002 to 2008, he served as President of Newmont Mining Corp from 2002 to 2007, during which the value of the company more than doubled.
- **Randall Oliphant** – Current Chairman, Randall Oliphant, has the second largest insider ownership position. From 1999 to 2003, he was the President and Chief Executive Officer of Barrick Gold Corporation. From 2006 to 2009, he was Chairman of Western Goldfields, which was merged into New Gold.

**Two large scale projects offer opportunity to expand production three fold over the next five years.**

- **Rainy River Project** – The Company's Rainy River project is expected to come on line in Mid-2017. The project has 3.8 million ounces of gold reserves and is expected to produce 300,000 ounces annually (equivalent to 75% of current production). Based on a \$1,200 average gold price, this project has an 11.4% rate of return.
- **Blackwater Project** – The Company's Blackwater Project is expected to begin development subsequent to the Rainy River project. This project has 8.2 million ounces of gold reserves and is expected to produce 485,000 oz. per year for the first nine years.

**Gold is a call option on the manipulation of interest rates by the Fed** - The Fed's extended low rate policy is very likely to result in a bubble in some financial markets. We have seen this bubble in low cost capital for commercial real estate and oil field development. If the bubble burst, as has been the case throughout history, many investors will seek to preserve wealth through buying gold. As mentioned earlier, the relative size of the gold market versus other financial sectors (equities & Bonds), can cause dramatic increase in the price of gold as there are too many dollars chasing too few investments.

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## Valuation:

	Current	2017	2020
Base Production oz.	400	400	400
Rainy River		300	300
Blackwater			480
Total Production	400	700	1180
Gold Price	\$1,200	\$1,200	\$1,200
Revenue	480,000	840,000	1,416,000
AISC	\$800	\$750	\$700
Total Costs	320,000	525,000	826,000
Cash Contribution	160,000	315,000	590,000
Shares Outstanding	510,000	510,000	510,000
Cash Contribution Per Share	0.31	0.62	1.16

The Table above shows our back of the envelop calculation for the cash contribution run rate at the end of the current year, the end of 2017 and the end of 2020. This metric is essentially a proxy for EBIT. If we assume an 8 to 10 multiple of EBIT, which is reasonable for the mining/metals industry, the stock valuation would be 2x to 4x its current prices in 3 to 5 years, if our assumptions hold true.

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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. Date	Relative Perf. vs. Russell 3000
M/A-Com Technology Solutions Holdings, Inc. (NASDAQ:MTSI)	28-Mar-15	\$35.81	\$33.73	-5.8%	-5.9%	1.5%
Kimball International, Inc. (NASDAQ:KBAL)	30-Apr-15	\$10.38	\$10.90	5.0%	-6.7%	9.7%
Ironclad Performance Wear Corp. (OTC:ICPW)	30-May-15	\$0.27	\$0.23	-14.8%	-7.7%	-8.1%
Customers Bancorp, Inc. (NYSE: CUBI)	30-Jun-15	\$26.87	\$27.50	2.3%	-6.0%	9.7%
Potbelly Corporation (NASDAQ: PBPB)	30-Jul-15	\$13.43	\$11.20	-16.6%	-7.6%	-10.5%
Cosi Inc. (NASDAQ: COSI)	31-Aug-15	\$1.17	\$0.63	-46.1%	-1.3%	-46.4%
Calloway Golf Company (NYSE: ELY)	30-Sep-15	\$8.39	\$9.94	18.5%	1.8%	12.9%
<b>Average</b>				<b>-8.2%</b>	<b>-4.8%</b>	<b>-4.4%</b>

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## **About Mossberg's Investor Digest**

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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