

Mossberg's Investor Digest

From the Editor...

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

This month's issue highlights 40-year-old Black Box Corporation (Nasdaq: BBOX), which helps business and government customers design, implement and manage their IT infrastructure, such as data communications networks, telephone systems, in-building wireless, data centers and AV/video services.

BBOX has a large footprint with 2,300 technical staff located in 89 offices in 33 countries. This is a significant differentiator for customers that want consistent deployment and management of IT solutions across large geographies. As such, customers include more than 1/2 of the 10 largest U.S. banks, hospitals, manufacturers, utility, and hotel companies, as well as all of the agencies of the DoD.

The Company has historically been a very active consolidator of smaller players, making more than 100 acquisitions in the past 15 years. While this strategy helped BBOX to build a broad national footprint, integration was limited with acquired companies being set up as mostly autonomous branch locations. In the past two years the company has embarked on a new strategy, which has put acquisitions on hold and is focused on centralizing sales, operations, and support functions. This transition has been difficult, as evidenced by declining sales and significant losses. However, once completed centralized functions should allow the company to garner significant efficiencies of scale and return to meaningful profitability.

Based on our assumptions and applying a conservative EV/EBITDA multiple of 7x, we believe shares could have 80%+ upside during the next 2 ½ years. As the Company's completes its shift to a centralized operating model and enters new higher growth end markets, we believe growth, margins and the price multiple could expand, which would provide further upside.

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December 2016

Issue #102

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...

Liquidity Services (Nasdaq: LQDT) - Headquartered in Washington D.C., Liquidity Services runs online auction marketplaces that helps corporations and government agencies liquidate surplus goods. LQDT procures product from many top 10 retailers, online retailers, and the U.S. government. After taking possession of the goods at one of its 9 warehouse facilities, the company sorts, barcodes, and palletizes common items. The items are then auctioned on one of its auction sites to EBay power users, thrift shops and back alley liquidators. The company has 2.6 million registered users of its websites liquidation.com, networkinternational.com, govliquidation.com, govdeals.com, truckcenter.com, and liquibiz.com.

Fogo de Chao, Inc. (FOGO) - Fogo de Chao, Inc. owns and operates full-service Brazilian steakhouses under the Fogo de Chão brand name in the United States and Brazil. The company's restaurants offer beef, lamb, chicken, pork, and seafood items, as well as liquor, beer, and wine. As of July 3, 2016, it operated 31 restaurants in the United States, 10 restaurants in Brazil, and 1 joint venture restaurant in Mexico. Fogo delivers 2x the average casual/ specialty dining restaurant EBITDA and more than 5x the average restaurant EBITDA of recent IPOs. Fogo has a proven ability to finance growth utilizing their internally generated Free Cash Flow.

Trecora Resources (NYSE: TREC) - TREC owns and operates a facility located in southeast Texas, just north of Beaumont, which specializes in high purity hydrocarbons and other petrochemical manufacturing. TREC also owns and operates a leading manufacturer of specialty polyethylene waxes and provider of custom processing services located in the heart of the Petrochemical complex in Pasadena, Texas. In addition, the Company is the original developer and a 35% owner of Al Masane Al Kobra Mining Co., a Saudi Arabian joint stock company.

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Best Idea Profile:

Black Box Corporation (Nasdaq: BBOX)

DESCRIPTION:

Headquartered just outside Pittsburgh, 40-year-old **Black Box Corporation (Nasdaq: BBOX)** helps business and government customers design, implement and manage their IT infrastructure, such as data communications networks, telephone systems, in-building wireless, data centers and AV/video services. The Company has more than 3,500 employees, including approximately 2,300 technical staff and 400 direct sales people.

Revenue is split roughly 80/20 between services and products businesses. Overall, approximately 85% of sales are generated in North America. 95% of service revenue and half of product revenue is generated from North America.

Services include design, sale and installation of new communications and data infrastructure systems, as well as support and maintenance of new and existing systems. For example, if a national retailer wanted to roll out new wireless data communications systems to several hundred stores, they could hire BBOX to help design/choose the right technology, then install, as well as maintain the system. Likewise, a regional bank could hire BBOX to provide ongoing support for its existing data networking systems in all of its branch locations. Support and maintenance services are provided on a contract, or per occurrence basis. The services business has a backlog that represents about half of the next 6 months' and a third of the next year's revenue.

BBOX has a large footprint with 2,300 technical staff located in 89 offices in 33 countries. This is a significant differentiator for customers that want consistent deployment and management of IT solutions across large geographies. As such, customers include more than 1/2 of the 10 largest U.S. banks, hospitals, manufacturers, utility, and hotel companies, as well as all of the agencies of the DoD.

Products include a wide variety of IT infrastructure equipment and accessories such as cabinets, racks, power supply, specialty networking, multimedia and keyboard/video/mouse ("KVM") switching, cables, connectors, etc. Products, which have an average

Black Box Corporation (Nasdaq: BBOX) Investment Data (as of 12/31/16)

Recent Price	\$15.25
52-Week Range	\$6.51 - \$17.05
Fiscal Year End	March
Dividend	\$0.48
Yield	3%
Shares Outstanding	15.2 M
Average Trading Volume (3 mos)	50,000
Market Capitalization	\$234M
Cash	\$16M
Long-term Debt	\$101M
Enterprise Value (EV)	\$319 M
TTM Revenue	\$884 M
EV/ Revenue	0.4x
TTM Adjusted EBITDA	\$28 M
EV/ EBITDA	9.4x
2016 EPS (consensus est.)	\$0.62
P/E	11.4
Book Value Per Share	\$9.70

order size of \$1,000, are sold through a sales team, as well as the internet and a catalog.

The Company has historically been a very active consolidator of smaller players, making more than 100 acquisitions in the past 15 years. While this strategy helped BBOX to build a broad national footprint, integration was limited with acquired companies being set up as mostly autonomous branch locations. In the past two years the company has embarked on a new strategy, which has put acquisitions on hold and is focused on centralizing sales, operations, and support functions. This transition has been difficult, as evidenced by declining sales and significant losses. However, once completed centralized functions should allow the company to garner significant efficiencies of scale and return to meaningful profitability.

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KEY INVESTMENT CONSIDERATIONS:

Transforming a former roll-up

By completing more than 100 acquisitions in 15 years, BBOX has gained some aspects of scale and scope, including a national service footprint with 2,300 technicians that are capable designing, implementing, and supporting technologies from multiple leading technology vendors. For enterprise customers with multiple locations in different geographies, and/or a mix of IT technologies, having a single service provider that can provide consistent service, or “one throat to choke”, is a compelling differentiator. However, integration efforts of past acquisitions were fairly minimal with acquired companies maintaining their existing disparate sales, operations and support functions.

Gaining of efficiencies of scale and scope – In the past two years, the Company has made significant progress in transitioning from a branch to a centralized organization.

- **National sales organization** – In April of 2015, management began the disruptive process of transitioning its sales model from autonomous branches, each focused on selling solutions sets native to their own branches, to a national selling organization offering comprehensive solutions. The new national model includes a consistent selling process and training, new sales leadership structure, a new combined commission plan and a single CRM tool. Obviously this has not been an easy process and given the typical sales cycle of 9 to 18 months, will take time to demonstrate improvement. However, considering that change led to turnover in approximately one third of the sales force, a decline in revenue in the mid-single digits should be considered an accomplishment.
- **Reducing the # of operating entities** – By the end of the current quarter, BBOX expects to have reduced the number of operating entities from 35 to 14.
- **Operational consolidation** – ERP systems have been consolidated from 12 to 4 with further consolidation expected. Solutions and services are now provided via a single standardized national service platform, whereas previously, separate branches had independent P&Ls with their own independent systems.
- **Purchasing power** – Since branches were run mostly independently, there was limited, if any, centralized purchasing. As purchasing functions are centralized, the company should gain a couple of percentage points of margin with its sizable purchasing power.
- **Working capital efficiency** – The centralized model has already allowed for significant improvements in working capital efficiency, with potential for more to come. Improvements came from faster inventory turns, slightly lower DSO's, and other improvements in worldwide cash management initiatives.

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Key areas of growth

Overcoming the decline in premises-based UCC equipment – The bulk of BBOX service-related revenue is related to design, installation and maintenance of premises-based Unified Communications technologies. This market is declining at a mid-single digit pace in favor of UCC deployed as a cloud solution. BBOX has invested in new end markets such as in-building wireless, security, audiovisual systems, and others, which is helping to offset the market decline in services related premises-based UCC technologies.

Enter new markets by leveraging national service footprint – While the market is slowly shifting away from premises-based UCC equipment, customers are increasingly investing in infrastructure upgrades to support the rapidly increasing number of devices that are being connected to the network. With its national service footprint operating under a centralized organization structure, BBOX is well positioned to help customers design, deploy and maintain the networks and myriad of devices that will be connected. As re-organization efforts are completed, management will begin shifting its attention to new areas for growth.

The Government is likely to spend again – Federal government business has historically represented about a quarter of BBOX's sales. With federal budget cuts and delays, this business has been negatively impacted over the past couple of years. In addition, the government business has also been disrupted by an initiative which is mostly completed, to consolidate BBOX' three federal business units. Recent federal government wins and an expected increase in infrastructure spending from the new administration, should bode well for growth in this area.

New Leadership with proven track record

New CEO with proven track record - E.C. Sykes joined the company at the end of February of this year. He spent 14 years at Flextronics, after its acquisition of Circuit Board Assembly (where he was CEO) in 1999. He was named Executive Officer of one of Flextronics largest and fastest growing business units, Industrial and Emerging Industries, which had 35,000 employees, operated 60 manufacturing sites in 19 countries. During his tenure at this role, revenue grew more than 6-fold to \$4 billion.

First outside leadership – Mr. Sykes is the first CEO appointed from outside of the company. Since 1998, the past two CEO's have been promoted from within. New leadership from the outside may be better suited to execute on a new strategy and business model. In addition to Mr. Sykes, a new CFO, Anthony Massetti, was appointed last month. Mr. Massetti was previously CFO of Avaya, NCR, and QLogic

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Valuation

(in \$,000s)	FY16 (March) *	FY17**	FY18	FY19
Products	166,536	161,540	161,540	161,540
Growth Rate		-3%	-	-
Services	746,119	701,352	736,419	773,240
Growth Rate		-6%	5%	5%
Total Revenue	912,655	862,892	897,959	934,780
Cost of Products	97,543	93,693	92,885	92,078
Cost of Services	544,775	504,973	526,540	549,001
Total COGS	642,318	598,666	619,425	641,078
Products GM	41.4%	42.0%	42.5%	43.0%
Services GM	27.0%	28.0%	28.5%	29.0%
Total Gross Margin	29.6%	30.6%	31.0%	31.4%
SG&A	255,665	240,000	238,000	240,000
% of Sales	28.0%	27.8%	26.5%	25.7%
Depreciation	10,311	10,311	10,311	10,311
Operating Profit *	4,361	13,914	30,223	43,391
Amortization	8,562	8,562	8,562	8,562
EBITDA	23,234	32,787	49,096	62,264
EBITDA Margin	2.5%	3.8%	5.5%	6.7%
* FY16 excludes asset impairment charges				
** FY17 Profitability excludes restructuring and inventory adjustment charges				

In our back of the envelop calculation above, we make the following assumptions for growth and improvement in profitability:

- **Revenue Growth** – We assume revenue growth will resume at a mid-single-digit growth pace after bottoming in fiscal 2017 (ending in March). Our growth assumes that a decline in UCC spending will be more than offset by a resumption in government spending, as well as growth in new market verticals.
- **EBITDA Margins** – We believe the improvement in profitability will not be significantly hindered by pricing pressure, or mix shift, and will more likely be directly correlated to how well management can execute on improving efficiencies and returning to even modest top-line growth. Over the next three years, we assume EBITDA margins will improve to just under 7% of sales based on improvement in operational efficiencies, centralized purchasing, and cost cutting initiatives. Given the nature of the business model and the fact that the company has previously delivered EBITDA margin performance in the range of 8% to 10%, we believe our profitability improvement assumption is conservative.

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Valuation (continued)

(in \$,000s)	FY16 (March)*	FY17**	FY18	FY19
Free Cash Flow		24,225	40,534	53,702
Dividend Payment		(7,000)	(7,000)	(7,000)
Debt Repayment		(25,000)	(20,267)	(26,851)
Debt Balance	120,000	95,000	74,733	47,882
Cash Balance	23,500	15,725	28,992	48,843
EV/EBITDA Multiple				7
Enterprise Value				435,847
Market Cap				436,808
Shares Outstanding				15,500
Share Price				28.18

- **Free Cash Flow** – We use EBIT as a proxy for Free cash flow, and assume that approximately half of cash flow generation will be used to pay down debt. Based on our assumptions, next debt will approach a zero balance in 2 ½ years.
- **Valuation** – Based on our EBITDA growth assumptions and applying a conservative EV/EBITDA multiple of 7x, we believe shares could have 80%+ upside during the next 2 ½ years. As the Company's completes its shift to a centralized operating model and enters new higher growth end markets, we believe growth, margins and the price multiple could expand, which would provide further upside.

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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 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
Calloway Golf Company (NYSE: ELY)	30-Sep-15	\$8.39	\$10.94	30.4%	23.8%	6.5%
New Gold (NYSE: NGD)	31-Oct-15	\$2.47	\$3.63	47.0%	17.3%	29.6%
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$10.17	-11.0%	13.8%	-24.8%
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$14.00	19.5%	20.0%	-0.6%
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$81.59	31.2%	31.7%	-0.4%
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	31.8%	16.7%
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$2.93	76.5%	22.4%	54.1%
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$5.39	-15.6%	20.5%	-36.2%
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$2.29	43.1%	18.5%	24.6%
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$10.49	31.3%	18.3%	12.9%
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$22.13	55.0%	11.7%	43.2%
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$17.00	52.9%	9.9%	42.9%
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$22.90	1.7%	8.9%	-7.2%
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$17.60	33.7%	14.4%	19.3%
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$6.82	-5.9%	3.1%	-9.0%
				Average	29.2%	17.8%
					17.8%	11.5%

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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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