

Mossberg's Investor Digest

From the Editor...

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Headquartered in Pasadena, 20-year-old **Guidance Software, Inc. (Nasdaq: GUID)**, is a leading provider of security software used by government agencies and large corporations, including 47% of Fortune 500, and 78% of Fortune 100.

Guidance software is used for the prevention and investigation of security breaches, allegations of fraud or misconduct, intellectual property theft, regulatory and data privacy compliance reporting, and corporate policy compliance.

The Company has strategically has focused on the large and rapidly growing market for cybersecurity. This has become an area of increasing concern for customers. There are 90 million attacks ever year including high profile hacks such as Ashley Madison accounts, Target Credit Card information, and the Democratic Party. The cost of cybercrime is substantial and could reach \$6 trillion by 2021, up from an estimated \$3 trillion in 2015. Because 90% of attacks come from unique malware, organizations are realizing that it not realistic to prevent every threat, and instead are installing solutions like GUID's that can detect and respond to malicious behaviors, incidents and malware. Gartner estimates that by 2020, 60% of security budgets will be focused on detection and response, an increase from less than 10 percent two years ago. The change in focus and positive customer response was evident during 2016, as GUID grew its forensic security suite by 165% during 2016 and was named by Gartner as the leader in endpoint market share in the EDR segment of the cyber security space.

Our back of the envelope calculation produces \$0.27 for 2017 non-GAAP earnings, which is conservative relative to management's guidance is for \$0.28 to \$0.36. Over the following two years, the model produces earnings growth of 25% to 30% annually. Given this growth rate, we believe a 25x earnings multiple is reasonable. When applied to the EPS for 2019 in our calculation, we end up with an \$11 stock value, which represents 65% upside over the next two years.

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February 2017

Issue #104

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...

ZAGG Inc (Nasdaq: ZAGG) - ZAGG designs, manufactures, and distributes product solutions for mobile devices. It offers solutions, such as glass and film screen protection products, keyboards for tablet computers and mobile devices, keyboard cases, earbuds, cables, and cases under the ZAGG and InvisibleShield brands. It sells its products through indirect channels, including big box retailers, domestic and international distributors, independent Apple retailers, university bookstores, and small independently owned consumer electronics stores, as well as directly to retailers or through distributors; and directly to consumers on its Website at ZAGG.com.

Forterra, Inc. (Nasdaq: FRTA) - Forterra has grown steadily to become one of North America's largest manufacturers of water-related drainage and transmission products. Today, they are a market leader across all of their business divisions, which include: Drainage Pipe & Products, Water Pipe & Products, Structural & Specialty Products and Storm water Management Systems. They employ a specialized technical sales force, including engineers and field service representatives, which enables them to deliver a high degree of customer service and create tailored solutions.

U.S. Concrete, Inc. (Nasdaq: USCR) - U.S. Concrete provides ready-mix concrete products to the construction industry. It operates in six major markets: San Francisco Bay, DFW, West Texas, Washington D.C., northern New Jersey and metropolitan New York. During 2011 its plant facilities produced approximately 4 million cubic yards of ready-mixed concrete from continuing operations and 3 million tons of aggregates. The company's customers include general contractors, concrete sub-contractors, design engineers, architects, governmental agencies, property owners and developers, and home builders.

Inventure Foods, Inc. (Nasdaq: SNAK)- is a marketer and manufacturer of specialty food brands in better-for-you and indulgent categories under a variety of Company owned and licensed brand names, including Boulder Canyon Foods™, Jamba®, Seattle's Best Coffee®, Rader Farms®, TGI Fridays™, Nathan's Famous®, Vidalia Brands®, Poore Brothers®, Tato Skins®, Willamette Valley Fruit Company™, Fresh Frozen™, Bob's Texas Style® and Sin In A Tin™.

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Best Idea Profile:

Guidance Software, Inc. (Nasdaq: GUID)

DESCRIPTION:

Headquartered in Pasadena, 20-year-old **Guidance Software, Inc. (Nasdaq: GUID)**, is a leading provider of security software used by government agencies and large corporations, including 47% of Fortune 500, and 78% of Fortune 100.

Guidance software is used for the prevention and investigation of security breaches, allegations of fraud or misconduct, intellectual property theft, regulatory and data privacy compliance reporting, and corporate policy compliance. The current mix of revenue split equally between three main areas...

- **1/3 E-discovery** – Software and services used to search the networks and devices for specific data and/or prove that all available data has been searched.
- **1/3 Forensics** – Software and services used mostly by law enforcement/ government agencies to analyze the trail of data on a wide variety of devices.
- **1/3 End point Detections and Response (EDR)** - This is a rapidly growing segment of the cybersecurity market addressed by GUID and includes solutions that can replace virus protection. EDR can remediate problems with malware without turning devices off. It can then find where malware may have spread to other devices and take action to prevent it from spreading.

Guidance Software, Inc. (Nasdaq: GUID)

Investment Data (as of 2/28/17)

Recent Price	\$6.60
52-Week Range	\$4.12 - \$7.80
Fiscal Year End	December
Dividend	N/A
Yield	-
Shares Outstanding	32 M
Average Trading Volume (3 mos)	75,000
Market Capitalization	\$220 M
Cash	\$13 M
Long-term Debt	\$3.5 M
Enterprise Value (EV)	\$191 M
2016 Revenue	\$110 M
EV/ Revenue	1.7x
2017 EBITDA guidance	\$9M to \$12M
EV/ EBITDA	16x to 20x
2017 EPS guidance	\$0.28 to \$0.36
P/E	18x to 24x
Book Value Per Share	\$4.91

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KEY INVESTMENT CONSIDERATIONS:

Transitioned from A "Private/Public" Company

Since GUID's founding in 1997 until last year, Founder, Shawn McCreight, served as the Chairman of the Board and has held various C-level management positions. With his Chairman and C-level roles, along with approximately 30% ownership stake, clearly Mr. McCreight held significant influence over the Company. That influence began transitioning two years ago when independent members of the board of directors began to implement significant organizational and structural changes. In order to offset stagnant sales trends and declining profitability, a new CEO was hired in April of 2015 and a new strategic plan was developed. After disagreements in direction with the board, Mr. McCreight was removed from his management and board positions in January of 2016. After a proxy battle last year, Mr. McCreight's influence on the company was limited to the appointment of two board members. We believe there is significant value to be unlocked when companies transition from founder-led to professional-led organizations. Based on the positive changes in the last couple of years, GUID is well-positioned to demonstrate that value creation.

New CEO - Patrick Dennis took the reigns as CEO in April of 2015 and has implemented significant change in the organization and strategy. Mr. Dennis previously held senior operating and marketing positions at EMC and Oracle. Under Mr. Dennis' leadership, GUID has implemented a new strategic plan focusing the company on Cybersecurity. There has been a major overhaul of the sales, marketing and product development functions, including new leadership, a new channel partner program, increased pricing, and a re-branded corporate image.

Results – The Company reported 4Q 2016 early this, month, posting a 7% increase in sales and a return to non-GAAP net income. 4Q16 non-GAAP EPS as \$0.09, versus a loss per share of \$0.05 last year. Importantly, the forensic security suite grew at an impressive 170% year over year.

Key Strategic Initiatives

Increasing use of channel to expand reach and aggregate sales capacity – As part of its strategic shift to better position the company to compete effectively in the data security space, GUID has created a channel model in North America that allows it to increase selling capacity. Historically, GUID's international revenue was 100% through channel partners, but in North America, only 25%. This was a big task exiting certain customers from direct to channel and had the potential to be very disruptive. Nevertheless, GUID's transition has been executed very well, resulting in increased quoting activity, growing pipeline, increase in average selling price, and increased deal size. By the end of 2016, 75% of sales in North America were derived from channel partners, which is within the targeted range. The Company formed several new channel partner relationships including:

- **Infinigate** – UK-based, value-added distributor of security products
- **Westcon Group** – A recognized world leader in the distribution of security solutions – highly selective...only works with industry leaders.
- **DarkMatter** – UAE-based, value-added integrator serving clients in the Middle East.
- **Atos** – European value added integrator with revenue of 12 billion and 100k employees in 72 countries
- **Arrow Electronics**

Reposition direct sales resources on larger accounts - There has been a transition period in which direct sales resources helped to onboard and train channel partners so that they could eventually close business themselves. As channel partners have shown success, direct sales resources are being directed to larger accounts and larger opportunities. This is beginning to result in larger deal size and growing pipeline.

New Corporate Brand Identity and Logo – To support strategic changes, Guidance launched a new branding initiative. Historically, Guidance branding has been associated with the forensic and digital investigations. With the Company's strategic expansion into cyber security, and other areas of risk management, the new brand better positions GUID a leader in all of its key markets.

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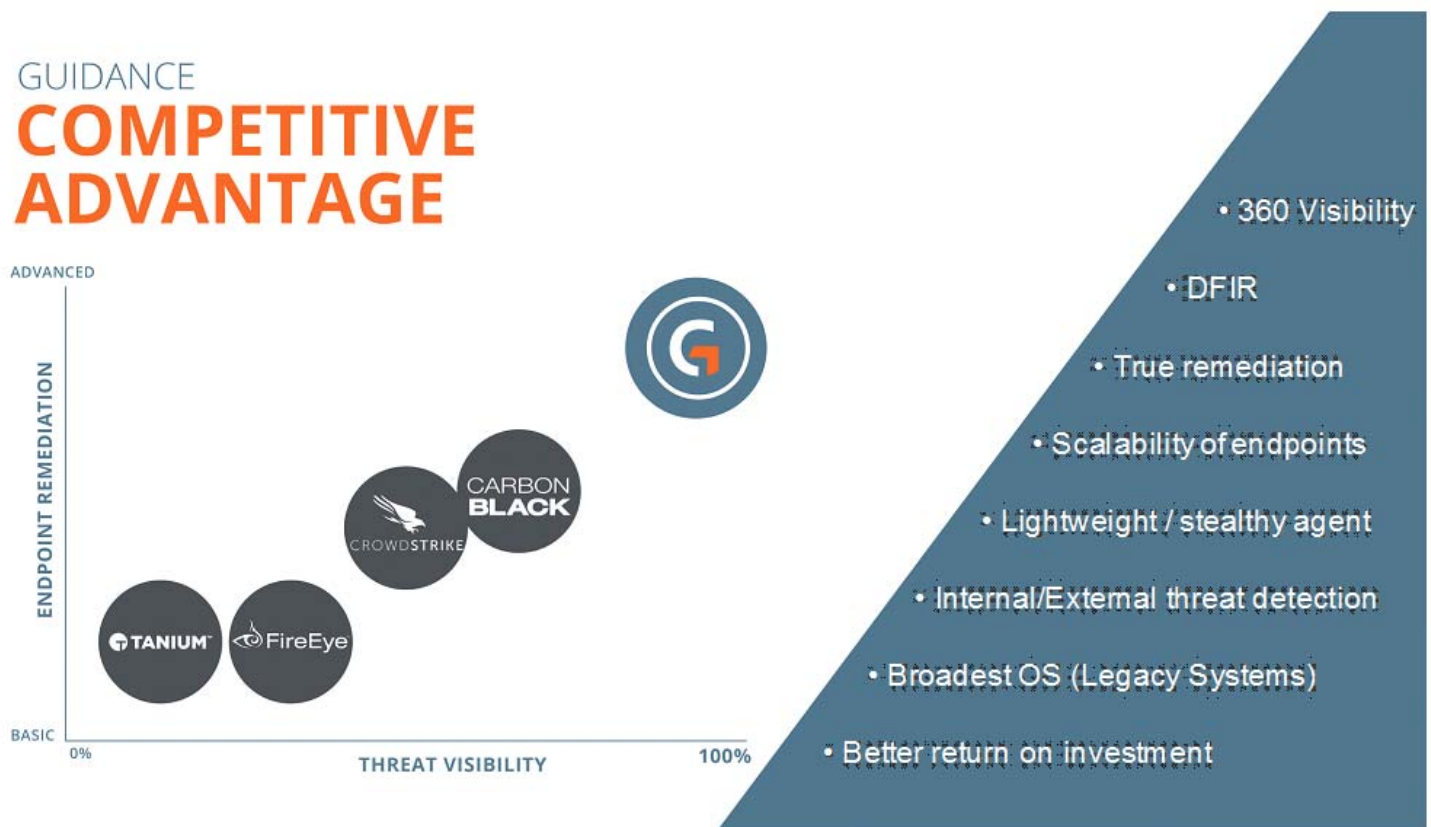
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Key Strategic Initiatives

Pivoting to Cybersecurity – The Company has strategically focused on the large and rapidly growing market for cybersecurity. This has become an area of increasing concern for customers. There are 90 million attacks ever year including high profile hacks such as Ashley Madison accounts, Target Credit Card information, and the Democratic Party. The cost of cybercrime is substantial and could reach \$6 trillion by 2021, up from an estimated \$3 trillion in 2015. Because 90% of attacks come from unique malware, organizations are realizing that it not realistic to prevent every threat, and instead are installing solutions like GUID's that can detect and respond to malicious behaviors, incidents and malware. Gartner estimates that by 2020, 60% of security budgets will be focused on detection and response, an increase from less than 10 percent two years ago. The change in focus and positive customer response was evident during 2016, as GUID grew its forensic security suite by 165% during 2016 and was named by Gartner as the leader in endpoint market share in the EDR segment of the cyber security space.

Well-positioned in EDR Market

As shown in the chart below from the company's investor presentation, GUID is well positioned to compete in the market for EDR. This chart is based on Gartner's recent assessment of the market.



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Valuation

	2016	2017	2018	2019
Total Revenue	110,518	115,293	120,457	126,045
Growth Rate		4.3%	4.5%	4.6%
Total Cost of Sales	33,216	31,537	32,545	33,608
Gross Profit	77,302	83,756	87,912	92,437
Gross Margin	69.9%	72.6%	73.0%	73.3%
Total Operating Expenses	97,878	85,855	87,558	89,378
As a % of sales	88.6%	74.5%	72.7%	70.9%
GAAP Net Income	(20,749)	(2,349)	104	2,810
Taxes	146	250	250	250
Share based - compensation	9,437	8,500	8,500	8,500
One-time events	8,174	-	-	-
Amortization of Intangibles	1,508	1,508	1,508	1,508
Non-GAAP - Net Income	(1,484)	7,909	10,362	13,068
Share Count	29,092	29,292	29,492	29,692
Non-GAAP - EPS	(0.05)	0.27	0.35	0.44

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

- **Revenue Growth** – We assume a blended growth rate of approximately 4.5% per year for the next three years. The blended rate reflects 10% growth in product revenue and 1-2% growth in services and maintenance. We believe there is upside to the growth projections if the company continues to gain traction with its cybersecurity focus. Our model produces \$115 million in revenue for 2017, which within the \$112 million to \$118 million guided by management
- **Gross Margin** – We believe gross margin will increase 30 to 40 basis points per year as the company continues its initiatives to increase pricing and as product revenue becomes a larger portion of the overall mix.
- **Operating Expenses** – We expect approximately 200 basis points per year of improvement for the next three years as the company benefits from cost cutting initiatives, and fixed costs leverage.
- **Share Count** – We assume 200k shares per year in additional shares related to compensation.

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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	\$10.09	20.3%	27.9%	-7.7%	
New Gold (NYSE: NGD).	31-Oct-15	\$2.47	\$2.94	19.0%	21.2%	-2.2%	
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$11.10	-2.9%	17.5%	-20.4%	
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$9.20	-21.5%	24.0%	-45.5%	
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$82.33	32.4%	36.0%	-3.6%	
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	36.2%	12.4%	
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$3.48	109.6%	26.4%	83.3%	
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$6.72	5.2%	24.5%	-19.3%	
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$2.21	38.1%	22.4%	15.7%	
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$15.29	91.4%	22.2%	69.1%	
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$22.64	58.5%	15.4%	43.1%	
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$14.85	33.5%	13.6%	20.0%	
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$23.65	5.1%	12.5%	-7.4%	
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$17.63	34.0%	18.2%	15.8%	
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$6.70	-7.6%	6.5%	-14.1%	
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$9.35	-38.7%	3.7%	-42.4%	
RadNet, Inc. (Nasdaq: RDNT)	31-Jan-17	\$5.80	\$6.00	3.4%	3.4%	0.1%	
				Average	25.2%	19.5%	5.7%

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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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