

# Mossberg's Investor Digest

## From the Editor...

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

Since its founding in 1980, Los Angeles-based **RadNet, Inc. (Nasdaq: RDNT)** has grown to be the largest owner and operator of fixed-site diagnostic imaging centers in the U.S. Imaging services include MRI, CT, PET, X-ray, mammography, ultrasound, and fluoroscopy imaging. All but 120 of its 7,300 employees work in more than 300 locations concentrated in regional networks in California, Maryland, Rhode Island, New Jersey and New York. The Company was founded by its current 73-year old CEO, Howard Berger, who owns approximately 13% of the outstanding stock. In total management owns approximately 20% of the company.

RadNet has been one of the fastest growing consolidators in its highly fragmented imaging industry, quadrupling the size of its revenue base since 2007. After taking a year off to digest several acquisitions in 2015, we expect acquisitions to resume in 2017 at a manageable pace.

Trading at an EV/EBITDA multiple of 6.7x, the stock has been negatively affected by concerns over the potential appeal of the Affordable Care Act, which is likely overdone, especially considering RDNT's low cost advantage.

We believe shares have more than 2x upside from current levels based on the combination of debt repayment, modest top line growth, stable margins and modest multiple expansion.

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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...

**Guidance Software, Inc. (Nasdaq: GUID)**- Guidance Software provides digital investigative solutions for e-discovery, computer forensics and data security. Forensics includes internal investigations, fraud, human resources and compliance applications. Ediscovery applications include litigation, regulatory inquiries and government matters. Cybersecurity deals with system integrity and sensitive data to help safeguard an organization's business by mitigating the costs and risks of an intrusion. Nearly two-thirds of Fortune 100 companies use the EnCase Enterprise platform and 40% use EnCase eDiscovery. Other customers include global governmental agencies, such as Internal Revenue Service, Federal Bureau of Investigation, Department of Justice, EU Council and NATO.

**Resonant Inc. (Nasdaq: RESN)**- Resonant is a late-stage development company creating innovative filter designs for radio frequency front-ends (RFFEs) for the mobile device industry. The RFFE is the circuitry in a mobile device responsible for analog signal processing and is located between the device's antenna and its digital baseband. Filters are a critical component of the RF front-end that select the desired radio frequency signals and rejects unwanted signals. It develops duplexer, a single-band filter design for mobile devices. The company is also developing multiplexer filter designs for two or more bands to address the carrier aggregation; and a series of reconfigurable filter designs for various RF frequency bands.

**Anworth Mortgage Asset Corporation (NYSE: ANH)**- is a mortgage real estate investment trust ("REIT"). Their principal business is to invest primarily in mortgage-backed securities on a leveraged basis. It invests in, finances, and manages leveraged portfolio of residential mortgage-backed securities that are guaranteed by Ginnie Mae, or by agencies or instrumentalities of the federal government, including Fannie Mae and Freddie Mac. The company also invests in non-agency mortgage investments that are guaranteed by a private institution, such as a commercial bank; and other mortgage-related investments consisting of mortgage derivative securities, mortgage warehouse participations, and subordinated interests, as well as in mortgage loans, other investments.

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Best Idea Profile:

RadNet, Inc. (Nasdaq: RDNT)

## DESCRIPTION:

Since its founding in 1980, Los Angeles-based RadNet, Inc. (Nasdaq: RDNT) has grown to be the largest owner and operator of fixed-site diagnostic imaging centers in the U.S. All but 120 of its 7,300 employees work in more than 300 locations concentrated in regional networks in California, Maryland, Rhode Island, New Jersey and New York.

During the last year, RDNT performed almost 6 million imaging procedures on the Company's 231 MRI systems, 144 CT systems, 46 PET or combination PET/CT systems, 49 nuclear medicine systems, 393 X-ray systems, 260 mammography systems, 498 ultrasound systems, and 105 fluoroscopy systems.

RadNet has been one of the fastest growing consolidators in its highly fragmented imaging industry, quadrupling the size of its revenue base since 2007.

In addition to imaging services, RDNT has smaller subsidiaries including eRAD, which develops and sells computerized systems for the imaging industry, including Picture Archiving Communications Systems ("PACS"). Imaging On Call provides tele-radiology services for remote interpretation of images on behalf of radiology groups, hospitals and imaging center customers.

The Company was founded by its current 73-year old CEO, Howard Berger, who owns approximately 13% of the outstanding stock. In total management owns approximately 20% of the company.

### RadNet, Inc. (Nasdaq: RDNT) Investment Data (as of 1/31/17)

<b>Recent Price</b>	<b>\$5.80</b>
52-Week Range	\$4.66 - \$7.98
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	46.5 M
Average Trading Volume (3 mos)	128k
Market Capitalization	\$275M
Cash	\$0.4 M
Long-term Debt	\$648 M
Enterprise Value (EV)	\$923 M
TTM Revenue	\$875 M
EV/ Revenue	1.1x
TTM Adjusted EBITDA	\$104 M
EV/ EBITDA	8.9x
2018 EPS (consensus est.)	\$0.37
P/E	16.0
Book Value Per Share	\$0.79

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## KEY INVESTMENT CONSIDERATIONS:

### Efficiencies of Scale and Scope in a Fragmented Industry

**Highly Fragmented Industry** - While RadNet's 300 locations represent just five percent of the estimated 6,000 imaging locations across the U.S., it is clearly the largest with no other fixed site imaging center company being even half of its size. The industry is highly fragmented with the majority of imaging centers owned by "mom-and-pops" and hospital operators. With the strategy to be the clear leader in regional markets, RadNet has concentration in certain geographies, such as California, where its 139 locations represent approximately 20% of the fixed site locations in the State.

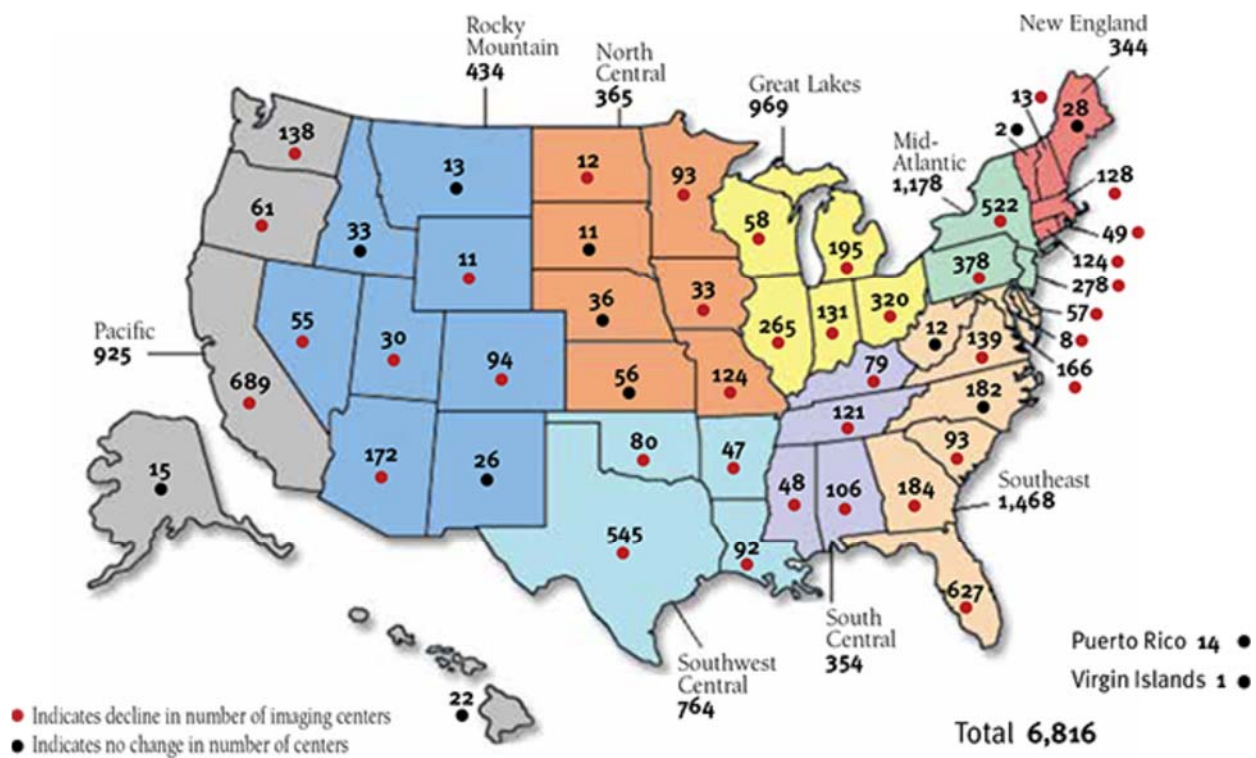


Figure. US imaging centers (by state and region), 2013.

**Enable low cost position** – Being the low cost provider is the key to success in a cost sensitive third-party payer system such as imaging. As the largest operator, the company has far greater buying power, as well as operational and marketing/contracting efficiencies. Essentially RadNet can acquire customers, service them, and collect payment at a far lower per unit cost, than smaller competitors.

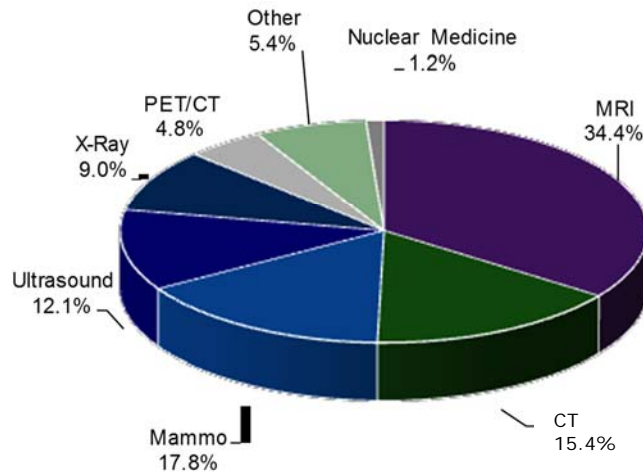
**One Stop Shopping/ Referrals** – Patient and referring physicians can use one location to serve the needs of multiple imaging procedures.

**eRad and Imaging On Call subsidiaries support additional efficiencies** – In addition to providing alternative revenue sources, eRAD and Imaging On Call are designed to make the RadNet imaging center operations more efficient and cost effective.

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## Efficiencies of Scale and Scope in a Fragmented industry (cont.)

4Q2015 Revenue Mix



**Less exposure to reimbursement changes** - As shown in the chart above, RadNet has a “multi-modality” strategy in which no more than a third of its revenue is comprised of any single imaging technology. In addition, RadNet has a diversified mix of payers. Approximately 55% of payments are made by commercial insurance companies, with only 20% coming from Medicare. Having a diversified base of modalities and payers insulates RadNet from unfavorable reimbursement trends in any one payer class, or type of procedure.

**Exclusive managed care capitation arrangements (12% of revenue)**– RadNet is the only fixed site operator to provide exclusive managed care capitation arrangements with prominent medical groups and Independent Physician Associations (IPAs). Per these contracts, RDNT receives a per-member-per month fixed price for exclusively providing outpatient imaging to more than 1.5 million lives in California. These contracts create a win-win-win for the RadNet, the insurance provider and the patient. The contracts, which average more than 10 years old, have an extremely high contract renewal rate and have a history of consistent rate increases. Not only does RDNT receive a predictable and steady stream of revenue from the capitation contracts, doctors from the capitated physician’s groups often refer RDNT to their non-capitated patients. Costs are also lowered, as the contracts eliminate the costs associated with receivables, bad debt and billing.

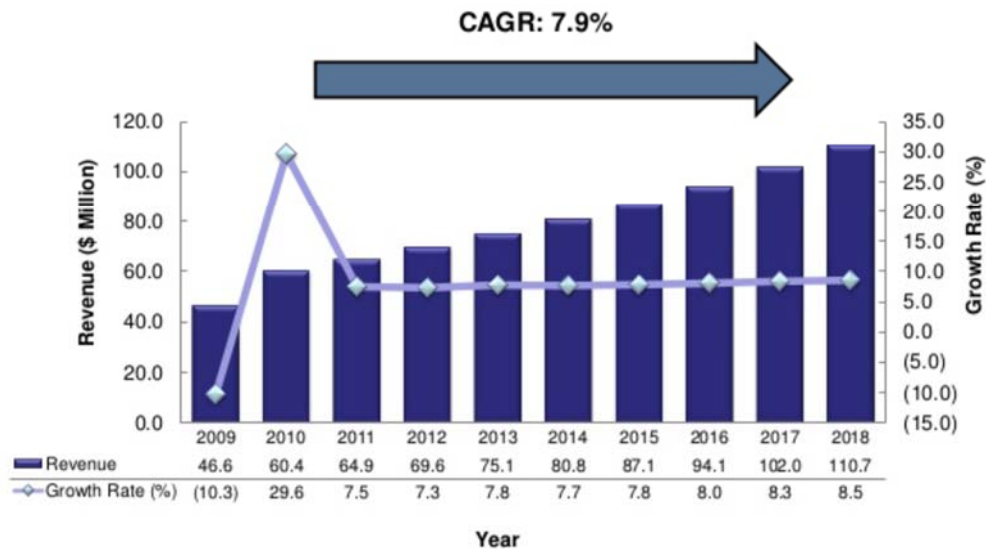
### Leading Consolidator

To gain efficiencies of scale and scope, RadNet has been an active industry consolidator. Since 2011, the company has acquired 135 centers. Acquisition Targets are generally characterized as single modality “Mom and Pop” operators that are not well capitalized and have higher cost structures. These marginal operators can be acquired at 3-5x EBITDA. Post-acquisition, with increased volumes from capitated contracts, additional new imaging modalities, and gaining efficiencies, profitability of acquired centers can be expanded significantly.

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## Trends in Diagnostic Imaging Market

### Total Medical Imaging Market Revenue Forecast



**Large and Growing Market** – The national imaging market is estimated to be more than \$100 billion, growing at approximately 8% per year. Growth drivers include the following trends:

- **Favorable Demographics** – The population of adults over 65 is expected to increase significantly.
- **Early detection = lower costs and better patient outcomes** – Imaging has been shown to reduce costs of healthcare delivery with earlier and more accurate detection diagnosis.
- **Technology Advances** - Technology advances have expanded cost-effective applications for diagnostic imaging.

**Trends that Favor RadNet** – Approximately 40% of industry revenue is derived from freestanding centers, such as those that RadNet operates. With RadNet's specialization, they provide superior service and have specialized radiologist readers, which are often not available at a Hospital based imaging center. Hospital-based imaging can be 3-4x more expensive for the patients and their insurance companies.

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## Valuation

	2016	2017	2018	2019
Revenue	890	908	926	944
Organic Revenue Growth	2%			
Acquisitions		50	50	50
<b>Total Revenue</b>		<b>958</b>	<b>976</b>	<b>994</b>
EBITDA	135	145	148	151
EBITDA Margin	15%	15%	15%	15%
CAPEX	57	62	63	65
Acquisitions		20	20	20
Interest Expense	37	37	35	34
<b>Free Cash Flow</b>	<b>45</b>	<b>26</b>	<b>29</b>	<b>33</b>
Cash	0.5	0.5	0.5	0.5
Debt	636	610	581	548
Market Cap	271	366	488	616
Enterprise Value	907	976	1068	1164
<b>EV/ EBITDA</b>	<b>6.7</b>	<b>6.7</b>	<b>7.2</b>	<b>7.7</b>
Shares Outstanding	46.7	46.9	47.1	47.3
Price	5.8	7.81	10.36	13.02
Debt to EBITDA	4.7	4.2	3.9	3.6

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

- **Revenue Growth** – We assume organic revenue growth of 2% will be driven by volume growth and stable pricing in capitated contracts. After taking a breather in 2016 to digest significant acquisition activity in 2015, we expect acquisition activity to resume in 2017 at a pace that will add approximately five percentage points of growth per year.
- **EBITDA Margins** – We assume that EBITDA Margins will remain unchanged at approximately 15% of revenue, which reflects the mid-point of management's guidance for 2016. We expect that any pricing pressure on reimbursement rates will be offset by gaining further efficiencies of scale and scope. We believe 15% EBITDA margin is reasonable, considering past margin performance in the high teens.
- **CAPEX** – We expect capex growth to mirror that of revenue growth
- **Acquisitions** – We assume the company will pay approximately 4x EBITDA to acquire smaller centers operating with EBITDA Margin at approximately 10% of revenue.
- **Free Cash Flow** – We expect remaining free cash flow after acquisitions to be used to lower debt levels.
- **Valuation** – We add a half turn to the valuation multiple in 2018 and 2019 each. As the Company is able to pay down debt and achieve a Debt/ EBITDA ratio below 4x, we expect the market to assign a higher multiple to shares. We believe this valuation multiple is conservative given the higher multiples assigned to comparable healthcare services providers.

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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	\$11.23	33.8%	22.9%	11.0%
New Gold (NYSE: NGD).	31-Oct-15	\$2.47	\$2.70	9.3%	16.4%	-7.1%
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$10.75	-5.9%	12.9%	-18.8%
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$11.70	-0.2%	19.1%	-19.2%
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$79.77	28.3%	30.6%	-2.3%
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	30.8%	17.8%
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$3.14	89.2%	21.4%	67.8%
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$6.48	1.4%	19.6%	-18.2%
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$2.35	46.9%	17.5%	29.3%
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$10.70	33.9%	17.4%	16.5%
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$23.79	66.6%	10.9%	55.7%
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$15.20	36.7%	9.1%	27.6%
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$20.02	-11.1%	8.0%	-19.1%
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$19.01	44.5%	13.5%	30.9%
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$6.87	-5.2%	2.3%	-7.5%
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$13.30	-12.8%	-0.4%	-12.4%
<b>Average</b>				<b>25.2%</b>	<b>15.7%</b>	<b>9.5%</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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