

Mossberg's Investor Digest

From the Editor...

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

Forty-year-old **LSI Industries Inc. (Nasdaq: LYTS)**, is headquartered in Cincinnati and provides indoor and outdoor lighting, digital signage, graphics and related technologies to help national and multi-site retailers better display their products, locations and brands.

LSI is the leading provider of outdoor lighting and signage to gas stations and convenience stores. They design and make custom light and signage solutions that are used in the pump canopy, the gas pump, on the building and in the store for customers such as BP, Chevron, Phillips 66, CVS, and other well-known retailers. The Company has used its leadership position in this market to successfully enter into other vertical markets such as quick service restaurants (Wendy's, Burger King), casual restaurants (Panera Bread), retail chain stores (Dick's, Kohl's), Banking (Chase, KeyBank), grocers (Costco, Whole Foods), automobile dealerships (Carmax, Honda, Toyota) and other vertical markets.

Unlike other lighting companies, LSI differentiates itself by integrating graphics, lighting, technologies and professional services in a complete solution, allowing customers to outsource the planning, design and implantation of an entire visual image program. Following the acquisition of Atlas Lighting products earlier this year, approximately 75% of the company's revenue is related to lighting products; 20% is related to graphics and 5% is related to technologies.

Our back-of-the envelope model produces \$0.64 in EPS for FY2019 and \$0.80 in FY2020. We believe a 20x multiple of earnings is reasonable given the company's growth rate and return profile. Applying that multiple to FY19 and FY20 earnings from our model yields a valuation that is 50% to 90% upside during the next two to three years.

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July 2017

Issue #109

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...

RadiSys Corporation (Nasdaq: RSYS) - Radisys Corporation provides software defined infrastructure, service aware traffic distribution platforms, real-time media processing engines, and wireless access technologies. This services acceleration company, helps communications and content providers, and their strategic partners, create new revenue streams and drive cost out of their services delivery infrastructure. Radisys' service aware traffic distribution platforms, real-time media processing engines and wireless access technologies enable its customers to maximize, virtualize and monetize their networks.

Gaia, Inc. (Nasdaq: GAIA) - Gaia, Inc., previously known as Gaiam, Inc., operates a global digital video subscription service and on-line community that caters to a unique and underserved subscriber base. Their digital content library of over 7,700 titles is available to their subscribers on most Internet-connected devices anytime, anywhere commercial free. Content on the network is currently curated into three channels, Yoga, Transformation and Seeking Truth, and delivered directly to the subscribers through their streaming platform. Gaia curates programming for these channels by producing content in-house with a staff of media professionals. This produced and owned content currently represents about 80% of total views.

Advanced Drainage Systems, Inc. (NYSE: WMS)— is an industrial growth company that delivers a comprehensive suite of water management products and superior drainage solutions for use in the construction and infrastructure sectors. ADS is the originator and leading manufacturer of innovative high performance thermoplastic corrugated pipe. The Company's broad product line includes corrugated high density polyethylene pipe, polypropylene pipe and related water management products, known as Allied Products, which are used across a broad range of end markets and applications, including non-residential, residential, infrastructure and agriculture applications.

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Best Idea Profile:

LSI Industries Inc. (Nasdaq: LYTS)

DESCRIPTION:

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The Company's 1,500 employees operate out of nine manufacturing and sales/service/technology facilities in five U.S. states. While most sales are in the U.S. (94%), the Company also sells in Canada, Australia and Latin America.

LSI Industries Inc. (Nasdaq: LYTS)

Investment Data (as of 7/31/17)

Recent Price	\$8.38
52-Week Range	\$8.12 - \$11.57
Fiscal Year End	June
Dividend	\$0.20
Yield	2.2%
Shares Outstanding	25 M
Average Trading Volume (3 mos)	85,000
Market Capitalization	\$212 M
Cash	\$4 M
Long-term Debt	\$55 M
Enterprise Value (EV)	\$263 M
TTM Revenue	\$329 M
EV/ Revenue	0.8x
FY18 EPS (consensus est.)	\$0.46
P/E	18.2x
Book Value/ Share	\$6.38

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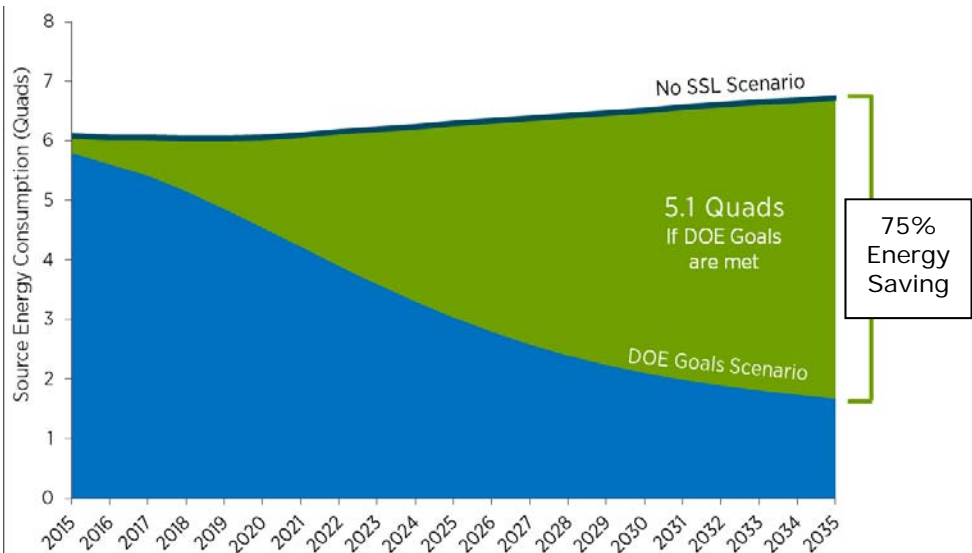
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KEY INVESTMENT CONSIDERATIONS:

Secular Growth Market with ample room for continued growth

Energy costs savings provide compelling reason to upgrade -

Per Department of Energy (DOE) estimates, lighting consumed approximately 15% of total electricity used in the United States in 2015. Without LEDs, the DOE projects that electricity consumption for lighting would grow to 6.7 million quadrillion BTU (quads) by 2035. However, due to efficiencies of LED lighting technology, the DOE projects consumption will be 1.6 quads. That is a 75% reduction in annual electricity consumption for lighting. Cumulatively, the DOE estimates 62 million quads of savings, equivalent to nearly \$630 billion of avoided energy costs from 2015 to 2035.



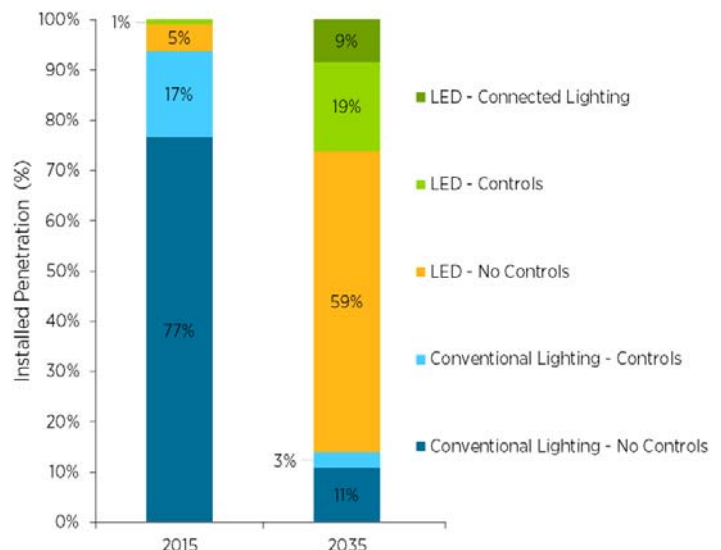
Lower maintenance costs – An LED light last for 100,000 hours. For perspective, that means you could run an LED light for 6 hours per day for 23 years without having to change the bulb. Comparatively, LEDs last five times longer than a Compact Fluorescent Light (CFL) and 50 times longer than a typical incandescent bulb. In other words, you will incur the time and maintenance costs five times to change a CFL light before you will have to replace an LED. Combined with energy costs saving and utility credits, in some places retrofitting to an LED solution can have as short as a 1 year payback.

Other reasons to retrofit -

- **Safety** – LED lights operate at peak heat of ~ 40° to 50° C, versus 230° for a HID light.
- **Brand image** - LEDs can be combined in any shape to produce highly efficient illumination. Individual LEDs can be dimmed, resulting in a dynamic control of light, color and distribution. Well-designed LED systems can deliver light more efficiently to the desired location and achieve lighting effects, not only for the eye, but also for the mood.
- **Environmental** – LED lights contain no mercury. They also save energy and generate less waste due to their long lifespan.

Long-term secular growth from retrofitting older technologies –

Per the DOE, there are 6.9 billion fixtures in the U.S. The chart to the right shows that market penetration for the installed base of lights will grow from less than 10% to more than 85% over the next 20 years.



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KEY INVESTMENT CONSIDERATIONS: (continued)

Growth Opportunities

Organic Growth – Management expects secular growth in the addressable markets that the company serves to grow at approximately 5% annually. Through competitive positioning and improvements in marketing and sales practices, management expects to take market share and grow at a faster pace than its addressable.

Digital Signage – LSI is making investments to grow its digital signage business under a program named SOAR. The program has had early success upgrading the Panda Express chain with digital menus at 600 locations. Management expects the digital signage business to create recurring revenue streams for content creation, and help promote its graphics and lighting businesses. While currently a small contributor to revenue, digital signage revenue is expected to double during FY17. Once established in this market segment, comparisons should also benefit from 12% to 14% growth of the overall market.

Smart Lighting Fixtures – LSI is also making investments in smart lighting fixtures with programs called AirLink and Smart Vision.

- **AirLink** – AirLink is an indoor wireless lighting design and control system that is easy to specify, install, use and sell. In addition to making it easy to design and/or reconfigure lighting schemes, AirLink customers can wirelessly control all aspects of their lighting. With AirLink, every office employee will be able to control individual office lights above their desk. AirLink also cuts installation labor by up to 90% versus standard control systems.
- **SmartVision** – Tying the light fixture with sensors, beacons, camera analytics, and smart tags, SmartVision will allow C-Store retailers and gas stations to interconnect with individual customers, giving them personalized insights, deals and other meaningful interactions. This product is in early development and in beta testing with Shell.

Acquisitions... “Bigger is Better” – The Company has initiated an acquisition program intended to accelerate growth and provide greater efficiencies of scale and scope in what is a highly-fragmented industry.

Atlas acquisition

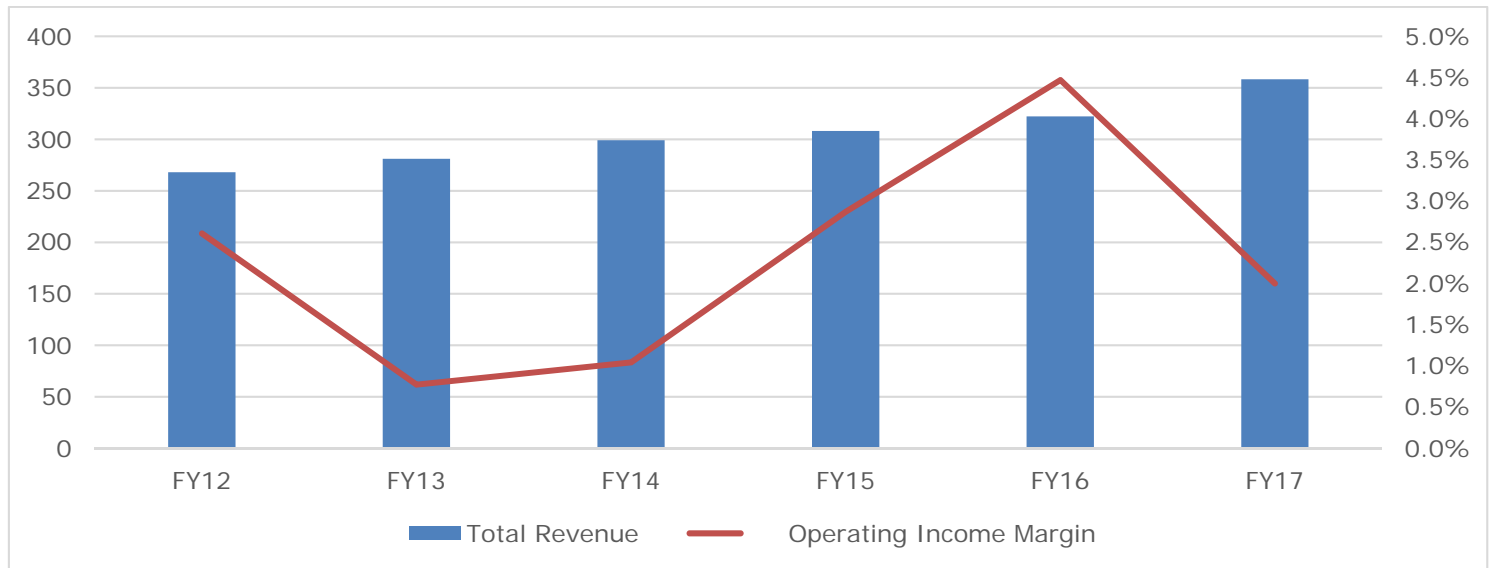
- **Valuation of \$97.5 million purchase price equals 10x EV/EBITDA** – During February 2017, LSI acquired Atlas Lighting Products for \$97.5 million (\$96 million in cash + 200,000 5-year warrants @ \$9.95). The purchase price represented a valuation of approximately 1.7x revenue (\$56MM), or 10x EV to EBITDA (\$9.7MM) after eliminating private company costs.
- **Adding a new go-to-market channel** – Historically, LSI's products were made-to-order, “Project-Based” solutions, mostly sold and shipped directly to the customer site. The key to the strategic nature of this acquisition is that Atlas will add a “stock and ship” channel to market, in which standard products are available off the shelf through distributors. The Acquisition added fixtures that are complimentary to LSI's product lines with minimal overlap. The Company expects to realize numerous cross selling opportunities with both product lines. There was also very little overlap in channel partners, with only one agent that was a reseller of both brands.
- **Accretive to earnings in Fiscal 2018** – Atlas will add \$57 million in sales and \$9 million in operating income. Atlas' current base of revenue is highly profitable, producing gross margins of 36%, which is 10 percentage points higher than LSI's. In addition to benefiting from a mix shift, profitability and cost savings are expected to come from eliminating redundant overhead costs, as well as utilizing Atlas' Asian sourcing channels to lower costs in several of the LSI's existing products. Combined with acquisition synergies, management expects the acquisition to be accretive in Fiscal 2018 (June).

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KEY INVESTMENT CONSIDERATIONS: (continued)

Improving profitably with significant operating leverage and efficiency gains

The Company has delivered a significant improvement in profitability over the last several years. By implementing continuous improvement (Kaizen) events to improve processes, improve quality and reduce costs, the operating margin has improved to 4.5%, relative to underperforming years in FY13 & FY14.



Recent Underperformance – In FY 2017, profitability is being affected by several factors including a rapid increase in the price of steel (one of the major cost inputs), investments in growth opportunities in smart lighting and digital signage, as well as noise around facility consolidation, and the major strategic acquisition of Atlas. We estimate that operating margin will drop to about 2% of sales during FY17, before benefiting from these strategic initiatives and showing a recovery in 2018.

Facility Consolidation – The Company is consolidating locations, one from each division, graphics, technology and lighting. Once completed, management expects to generate \$2.5 million in annual savings.

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Valuation

	FY16	FY17	FY18	FY19	FY20
Atlas Lighting		36	57	60	63
Atlas Growth			0%	5%	5%
LSI Revenue	322	322	338	355	373
LSI Growth		0%	5%	5%	5%
Total Revenue	322	358	395	415	436
Gross Profit	84	88	103	112	122
Gross Margin	26.0%	24.5%	26.0%	27.0%	28.0%
Operating Expenses*	69.7	80.6	87.0	88.2	91.5
Operating Expense as % of Revenue	21.6%	22.5%	22.0%	21.3%	21.0%
Operating Income	14	7	16	24	31
Interest Expense		0.9	2.5	2.1	1.5
Tax Rate	32%	32%	32%	32%	32%
Taxes	4.6	2.0	4.3	7.0	9.3
Net Income	10	4	12	17	21
Net Income Margin	3.0%	1.3%	3.4%	4.8%	5.7%
Diluted share Count	25.6	25.8	26	26.2	26.4
EPS	\$0.38	\$0.17	\$0.44	\$0.64	\$0.80

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

- **Revenue Growth** – In FY18, we assume there will be no growth for Atlas, as some product line rationalization is offset by cross selling opportunities. After 2018, we assume organic growth of 5% for both LSI and Atlas, which is conservative, given management's call for above market growth.
- **Gross Margin** – During FY18, we expect recent cost pressure to be offset by a mix shift and increased pricing, returning gross margin level back to those achieved during FY16. Thereafter we expect sourcing efforts, increased utilization, and other efficiency initiatives will add at least 100 basis points per year for the next two years.
- **Operating Expenses** – By 2020, we expect at least 100 basis points of margin improvement from operating leverage and efficiency initiatives.

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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	\$12.71	51.5%	29.9%	21.6%	
New Gold (NYSE: NGD).	31-Oct-15	\$2.47	\$3.30	33.4%	23.0%	10.4%	
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$11.10	-2.9%	19.3%	-22.2%	
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$9.55	-18.5%	25.8%	-44.3%	
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$90.37	45.3%	38.0%	7.3%	
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	38.2%	10.3%	
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$3.80	128.9%	28.3%	100.6%	
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$8.93	39.7%	26.4%	13.4%	
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$2.58	61.3%	24.2%	37.0%	
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$22.91	186.7%	24.1%	162.7%	
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$23.23	62.7%	17.2%	45.5%	
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$14.20	27.7%	15.3%	12.4%	
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$33.62	49.4%	14.2%	35.2%	
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$15.31	16.3%	20.0%	-3.6%	
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$8.41	16.0%	8.1%	7.9%	
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$7.90	-48.2%	5.3%	-53.5%	
RadNet, Inc. (Nasdaq: RDNT)	31-Jan-17	\$5.80	\$7.75	33.6%	5.0%	28.7%	
Guidance Software, Inc. (Nasdaq: GUID)	28-Feb-17	\$6.60	\$7.08	7.3%	3.1%	4.2%	
Calgon Carbon Corporation (NYSE: CCC)	31-Mar-17	\$14.25	\$15.88	11.4%	3.1%	8.3%	
LRAD Corporation (Nasdaq: LRAD)	30-Apr-17	\$1.51	\$1.60	6.0%	2.1%	3.9%	
Trecora Resources (NYSE: TREC)	31-May-17	\$10.65	\$11.60	8.9%	4.3%	4.6%	
EVINE Live Inc. (Nasdaq: EVLV)	30-Jun-17	\$1.00	\$1.13	13.0%	1.0%	12.0%	
				Average	35.4%	17.1%	18.3%

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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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