

# Mossberg's Investor Digest

March 2016

Issue #93

## From the Editor...

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

Headquartered in Boston, **Kopin Corporation (Nasdaq: KOPN)** has historically been the leading provider of displays, optical lenses and other components and modules for military applications such as heads-up displays for fighter aircraft and thermal sites. While continuing to sell and develop new products for military applications, Kopin is successfully transitioning its technologies for their use in consumer and enterprise applications. These markets are in the early stages of adoption and offer a significantly larger addressable size. According to Goldman Sachs, the consumer head-worn device (HMD) market is expected to reach \$25 billion by 2025.

Kopin has taken an early lead in the space, garnering component supplier wins with five major OEMs including Fujitsu, Motorola, Google, Garmin and Intel. At the Recent CES show, 15 companies displayed HMD devices with "Kopin inside".

Despite success, Kopin's stock price declined 40% during the first quarter of 2016. Clearly there appears to be a motivated seller "puking up stock" for non-fundamental reasons. If there is more stock for sale, the stock could go lower, but it is hard to predict the bottom and at an enterprise value of just \$15 million, there seems to be an extreme margin of safety.

As always, I appreciate your feedback.

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

## March 2016 Issue

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...

**Tucows Inc. (Nasdaq: TCX)** - Tucows one of the largest providers of wholesale domain name registrations in the world with more than 8 million domain names under management. Since entering the domain name market in January 2000, Tucows has grown its distribution channel to more than 9,000 active resellers in more than 100 countries. Tucows has a strong balance sheet and is consistently generating positive cash flow from operations, providing a solid foundation for future growth.

**Farmer Brothers Co. (Nasdaq: FARM)** - is a leading manufacturer, wholesaler and distributor of a variety of high quality coffee products and a distributor of tea and culinary products to food service establishments and retailers nationwide. Farmer Brothers has one of the most complete local, regional, and national DSD networks in the coffee industry. Their customers include restaurants, hotels, casinos, offices, quick service restaurants ("QSR's"), convenience stores, healthcare facilities and other foodservice providers, as well as private brand retailers in the QSR, grocery, drugstore, restaurant, convenience store, and independent coffee house channels.

**Federated National Holding Company (Nasdaq: FNHC)** - is an insurance holding company, which, through its subsidiaries and its contractual relationships with its independent agents and general agents, controls and generates revenue from substantially all aspects of its insurance businesses. FNHC generates sustainable annual growth by Growing Market Share, Improving Product Sales and Product Mix, Containing Costs and Evaluating Strategic Acquisitions. Their intent is to attract and retain customers for their insurance needs by providing outstanding customer service, quality and value in all products and services that they offer, at the lowest possible cost.

# Mossberg's Investor Digest

## 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.	Relative Perf. vs. Russell 2000
M/A-Com Technology Solutions Holdings, Inc. (NASDAQ:MTSI)	28-Mar-15	\$35.81	\$43.73	22.1%	-10.5%	32.6%
Kimball International, Inc. (NASDAQ:KBAL)	30-Apr-15	\$9.97	\$11.64	16.8%	-9.0%	25.7%
Ironclad Performance Wear Corp. (OTC:ICPW)	30-May-15	\$0.27	\$0.28	1.9%	-10.9%	12.8%
Customers Bancorp, Inc. (NYSE: CUBI)	30-Jun-15	\$26.87	\$23.75	-11.6%	-11.4%	-0.2%
Potbelly Corporation (NASDAQ: PBPB)	30-Jul-15	\$13.43	\$13.60	1.3%	-9.9%	11.1%
Cosi Inc. (NASDAQ:COSI)	31-Aug-15	\$1.17	\$0.88	-24.8%	-4.2%	-20.6%
Calloway Golf Company (NYSE: ELY).	30-Sep-15	\$8.39	\$9.14	8.9%	0.9%	8.1%
New Gold (NYSE: NGD).	31-Oct-15	\$2.47	\$3.89	57.5%	-4.4%	61.9%
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$11.36	-0.6%	-7.3%	6.7%
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$13.13	12.0%	-2.2%	14.3%
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$63.71	2.5%	7.2%	-4.8%
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$20.87	-3.1%	7.4%	-10.5%
				<b>Average</b>	<b>6.9%</b>	<b>11.4%</b>

We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea profiles are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Additional disclosures can be found under the Disclosures portion of the Mossberg's Investor Digest website.

# Mossberg's Investor Digest

Best Idea Profile:

Kopin Corporation (Nasdaq: KOPN)

## DESCRIPTION:

Headquartered in Boston, Kopin was founded in 1984 with 30 patents, a group of scientist from MIT, and VC funding. For the past 26 years, the company has been developing components for wearable technology and has grown its patent base for display, software, speech enhancement, noise cancellation, and ergonomic wearable systems more than tenfold to 300+ patents.

Kopin has historically been the leading provider of displays, optical lenses and other components and modules for military applications such as heads-up displays for fighter aircraft and thermal sites. While continuing to sell and develop new products for military applications, Kopin is successfully transitioning its technologies for their use in consumer and enterprise applications. These markets are in the early stages of adoption and offer significantly larger addressable market. According to Goldman Sachs, the consumer head-worn device (HMD) market is expected to reach \$25 billion by 2025.

The Company's business model provides components and license technologies, eventually looking to become the "Intel inside" for OEMs designing HMD devices for enterprise and consumer applications. Kopin has taken an early lead in the space, garnering component supplier wins with five major OEMs including Fujitsu, Motorola, Google, Garmin and Intel. At the Recent CES show 15 companies displayed HMD devices with "Kopin inside".

To demonstrate one consumer use case of its latest technologies, Kopin introduced Solos eyewear at CES in January and expects to begin shipping product later in the year. Solos eyewear is designed for cycling enthusiasts and offers riders the ability to view critical information about speed, direction, etc. on a heads up micro display inside of the eyewear.

## Kopin Corporation (Nasdaq: KOPN)

Investment Data (as of 3/31/16)

<b>Recent Price</b>	<b>\$1.66</b>
52-Week Range	\$1.57 - \$3.80
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	67 M
Average Trading Volume (3 mos)	52 M
Market Capitalization	\$111 M
Cash*	\$96 M
Long-term Debt	-
Enterprise Value (EV)	\$15 M
Book Value	\$1.63
P/ Book	1.0 x
TTM Revenue	\$38 M
EV/ Revenue	0.6 x
2016 EPS (consensus)	(\$0.23)
P/ EPS	n/a

\* Cash as of 12/31/15 plus cash of \$15 million received in January 2015

# Mossberg's Investor Digest

## KEY INVESTMENT CONSIDERATIONS:

### **Growth of head-worn display devices.... It's not a matter of "if" it's "when"**

**It's going to be a big market** - I believe the use case has been made that these devices hold the promise to improve the way we live, work and play. The technical challenges are being solved and price points should allow for wide spread adoption. TECHanalysis expects that the worldwide market for head-worn displays to reach 30 million units worldwide in 2020. As with the adoption of any new technology the hard part is to figure out when the ramp will begin. Last year when Google introduced its Glass product for consumers, the ramp appeared imminent. However, the product's \$1,500 price point, lack of aesthetics and privacy issues met with weak consumer adoption and ultimately led Google to pull the product out of the consumer market. While Google's move to pull out of the consumer market delayed the ramp of the head-worn display market, it did not change how these devices can add value to our lives. Instead, Google Glass allowed the industry to imagine a whole host of new applications for head-born displays. Google is now relaunching Glass for enterprise applications.

**Use-specific applications are the path forward.... How to avoid being perceived as "weird", or "creepy"** – Because they are worn on your body, these devices become an extension of your person, in the same way that a traditional designer watch or sunglasses do. There is a reason why people are willing to pay \$300 for a pair of sunglasses, or \$10,000 for a watch... it is because they want others to view them in a positive way associated with the style and/or perception of the brand. The last thing most people want to wear on their wrist or head is a device that will create a negative perception. (I.e....is that guy recording me...is he looking up my online profile?) Google Glass is a platform technology designed for multiple end-user applications. In a way, the Google Glass platform was too broad because users didn't quite understand what they could do with the technology. In contrast, the current and next generation of head-born display devices are being designed and marketed for more specific end-user applications and have very clear value propositions to improve experiences, performance, and/or efficiencies. Because these devices are directly associated with the specific activity, others know why users are wearing the device and the "creepy" factor goes away. Also, users are likely to pay higher price points for devices that have a direct correlation with helping improve their experience, or increase efficiency. For example, if a fisherman will pay \$1,000 for a rod and reel that helps him land more fish, you would expect that same fisherman to pay more for a wearable device that gives aheads up display of a fish finder, speed of the boat, water temperature, etc.

**Plenty of Runway** – Trying to predict a ramp is very challenging and often smaller companies that are developing new technologies face the added risk that a delay in adoption can cause a stain on the balance sheet requiring a dilutive financing, or worse. With \$96 million in cash, Kopin is in an enviable financial position. With a current annual burn rate of \$20 million, the company has five years of runway before they would run into trouble.

**Adoption is off to the races...literally** – During the 4Q earnings call earlier this month, management announced that there were more than 100,000 headsets sold into cycling and drone racing markets each. Before you read further, search for "Drone Racing" in YouTube. In the videos you will see Drone pilots using virtual reality headsets to give them a first person view of the drone at speeds of 100 miles per hour making its way through a course. Kopin has 90% market share providing components for these devices. This sport is growing very rapidly and is a good example of new specific applications that were not on the radar several years ago.

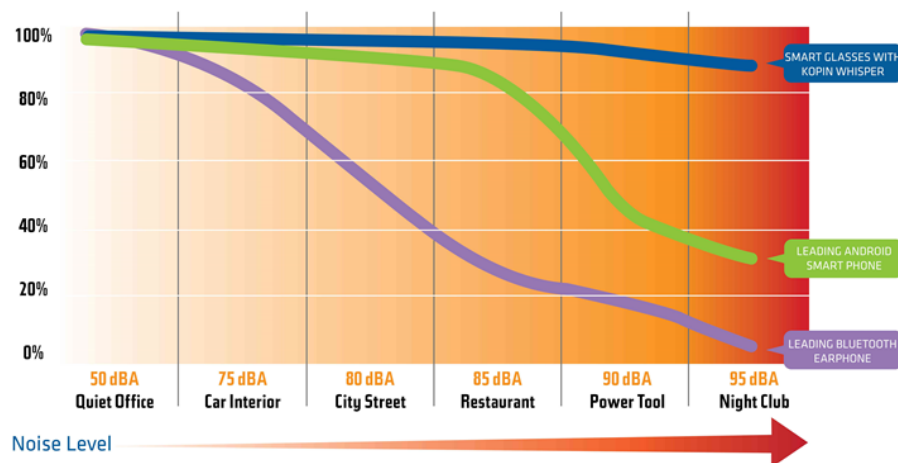
# Mossberg's Investor Digest

## KEY INVESTMENT CONSIDERATIONS: (Continued)

**Kopin recently introduced technologies that overcome critical hurdles to widespread adoption.**

- 1) **Battery Life** – Kopin has collaborated with Hitachi/Maxell, a top-tier Japanese battery manufacturer, to introduce a new battery that replaces graphite anodes with silicon. For starters, this technology will produce more than 2X more energy density than today's Lithium batteries. Kopin has exclusive rights to this technology in headgear
- 2) **Voice Control for hands free use** – Kopin has developed a voice chip called "whisper" that provides almost 2X improvement in human-to-machine (H2M) automatic speech recognition (ASR) rates. The chart below shows the performance of whisper relative to other leading technologies. I believe the line in green is DSP Group's latest technology.

Speech Recognition – Dictation Accuracy



**Puking up stock** – During the first quarter of 2016, Kopin's stock price declined 40%, while average daily trading volume was approximately 50% higher than any other quarter in the past two years. Clearly there appears to be a motivated seller doing what I call "puking up stock". Considering the positive announcements over the past couple of quarters, it's hard to figure why any investor would be a seller based on fundamental reasons. Instead, it appears seller(s) are exiting for non-fundamental reasons such as fund redemptions, margin calls, changes in fund personnel, etc.

There was plenty of non-fundamental selling going on during the first quarter, as money continued to flow out of funds that invest in small cap stocks. More than two thirds of small cap growth funds underperformed their index last year, and 2015 was the first down year for the Russell 2000 since the depression, declining 5% for the year. Despite the irrational behavior of buying high and selling low, it's not a surprise that investors pulled money out of these funds during the beginning of 2016 after reading through their annual statements in January. Making matters worse, hedge funds, which tend to be significant incremental owners of small cap companies, suffered their worst year since the financial crisis with 979 funds closing during 2015.

I expect that when the stock price traded down during large volume days of the first quarter, KOPN had a shareholder(s) that was/were selling for a non-fundamental reasons. If there was a large block(s) of stock being shopped around, it is more difficult during a period of fund outflows for smaller companies to find a market clearing price and they often trade at what later on seems to be an obvious bargain basement price. If there is more stock for sale for non-fundamental reasons, the stock could go lower, but it is hard to predict the bottom and at an enterprise value of just \$15 million, there seems to be an extreme margin of safety.

We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea profiles are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Additional disclosures can be found under the Disclosures portion of the Mossberg's Investor Digest website.

# Mossberg's Investor Digest

## Valuation

**Not much needs to go right to make this a worthwhile investment** - I took a different approach to valuing Kopin. Instead of attempting to forecast specific unit volumes by application and then applying a discount based on the likelihood that my forecast would play out as expected, I started with the question... what is the minimum level of adoption needed to produce a 2-3x return in three years from buying the stock at the current levels. If and when the valuation increases, I can then sharpen my pencil to see if an every higher valuation is reasonable. The table below illustrates how our "back of the envelope" calculation yields \$0.23 in EPS for 2018. A 20x multiple of earnings would yield a stock price more than 2.5x greater than current levels.

### Back of the Envelope Assumptions:

- **Legacy Revenue:** Recently announced military contracts will be in full affect and provide \$10 to \$20 million worth of annual revenue ramping from 2017. In 2018, we assume the ramp has not happened yet. We conservatively assume zero incremental revenue from other military applications and \$5 million in funded R&D revenue, which is consistent with previous years.
- **Consumer and Enterprise Revenue:** We assume 2 million units at \$35 ASP contribution per unit for consumer and 400,000 units with \$150 ASP contribution per unit for enterprise applications. Given that two of the consumer applications are already in the 100's of thousands, we think this should be very achievable in the next three years.
- **Gross Margin:** We assume a 45% contribution margin, which should prove to be conservative given the mix of license and product sales.
- **R&D and SG&A** – I increased these line items to \$50 million, which is \$10 million more than the current spend rate and reflect variable costs of these expense lines.
- **Share count:** 65 million shares reflects modest share creep from employee stock compensation.

	# of Units	Rev per Unit	2018
Joint Strike Fighter			5,000,000
Thermal Sites			5,000,000
Military Applications			10,000,000
Funded R&D			5,000,000
Consumer Applications	2,000,000	\$35	70,000,000
Enterprise applications	400,000	\$150	60,000,000
<b>Total Revenue</b>			<b>145,000,000</b>
Gross Margin	45%		65,250,000
SG&A			25,000,000
R&D			25,000,000
Operating Income			15,250,000
Taxes			-
Shares Outstanding			65,000,000
EPS			0.23
Valuation Multiple			20
<b>Valuation</b>			<b>\$4.69</b>

We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea profiles are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Additional disclosures can be found under the Disclosures portion of the Mossberg's Investor Digest website.

# Mossberg's Investor Digest

## **Subscription Information**

Subscribe to Mossberg's Investor Digest at <http://midresearch.com/subscribe/>

### **12 New IDEAS per year**

### **Immediate Access Annual Subscription: \$295/ year**

Immediate Access Annual subscribers will receive that month's issue during or before the end of each month.

### **Annual Subscription: \$245/ year**

Annual subscribers will receive that month's issue two weeks later than Immediate Access Subscribers

## **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.

## **Disclosures**

**Not Investment Advice:** Investors should consult a financial advisor before investing in any securities highlighted in the Digest or subscribing to any newsletter service. We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea Profiles highlighted in Mossberg's Investor Digest are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Mossberg's Investor Digest is not suitable for people seeking low to moderate risk investments.

It is the policy of the publisher to follow the CFA Institute's "Standards of Practice" regarding disclosure of potential conflicts of interest. The publisher's policy is to avoid conflicts of interest when possible. However, when potential conflicts are unavoidable, the publisher's policy is to disclose material business relationships between it and issuers of securities highlighted in the letter. In addition, the publisher's ownership in securities highlighted in the letter is disclosed. By disclosing potential conflicts of interest, subscribers and prospective subscribers will have additional information to evaluate the objectivity of ideas highlighted in the newsletter.

\*There are no material business relationships between the publisher and the securities highlighted in this issue.

\*As of March 2016, the publisher owns shares in COSI, CUBI and DSNY.

---

We attempt to provide subscribers with reasoned opinions based on our analysis of publicly available information from sources believed to be reliable, but make no representations as to its accuracy or completeness. Best Idea profiles are not based upon individual needs of subscribers nor are they an offer to buy or sell securities. Additional disclosures can be found under the Disclosures portion of the Mossberg's Investor Digest website.

[www.midresearch.com](http://www.midresearch.com)