Mossberg's Investor Digest

From the Editor…

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

This month's issue highlights Ottawa-based **Mitel Networks Corporation (Nasdaq: MITL)**, which is one of the top providers of business communications gear in the world. (By market share #4 globally and #1 in Europe). Founded in the 1970's the Company has a large global footprint connecting 60 million business users in more than 100 countries. The Company has more than 2,500 channel partners and 4,400 employees.

The Company is transitioning from a provider of premises equipment that has long upgrade cycles to a recurring revenue model based on pay-as-you-go cloud subscription services. With more than 2.2 million cloud-based users, Mitel is by far the market leader in this space. As the cloud-based business is expected to grow at 20%+, margins should expand and revenue will become more recurring, predictable and less dependent on upgrade cycles.

Last year, the company added a new high growth business, Mobile networking, through its acquisition of Mavenir. This brings a new customer base and rapidly growing addressable market. Mobile carriers are increasingly looking to deploy voice, video and messaging services over LTE or Wifi Networks. There is a dramatic acceleration in the adoption of the IP based networks, as mobile carriers gain efficiency, increase network capacity and can introduce new services. According to Deloitte, 100 carriers worldwide will be offering at least one packet-based voice service at the end of 2016, a 6x expansion from the beginning of 2015. Mitel has won business from 50 plus carriers, including several tier ones.

Based on our EBITDA growth assumptions and applying the current EV/EBITDA multiple of just under 9x, we believe shares could have 90%+ upside during the next two years. As the company's business model shifts from one-time lumpy sales to more recurring and predictable revenue, we believe the price multiple could expand by a few turns, which would provide further upside.

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November 2016 **Issue #101**

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…

Capital Southwest Corporation (Nasdaq: CSWC) - Capital Southwest Corporation is a business development company specializing in credit and private equity investments in middle market companies. Capital Southwest is an internally managed which offers superior shareholder alignment. Capital Southwest typically invests in growth financing, bolt-on acquisitions, new platform acquisitions, refinancing, dividend recapitalizations, early-stage financing, sponsor-led buyouts, and management buyouts situations. The average investment size is between $5-$20 Million.

OMNOVA Solutions Inc. (NYSE: OMN)- OMNOVA Solutions Inc. provides emulsion polymers, specialty chemicals, and engineered surfaces for various commercial, industrial, and residential end uses in North America, Europe, and Asia. The company operates in two segments, Performance Chemicals, which is 75% of sales and Engineered Surfaces, 25% of sales. Lamination of OMNOVA's products is faster and easier than other processes such as high pressure lamination. Their 3D offerings allow for rounded profiles, eliminating the need for edge-banding and T-molding. End uses include fixtures and displays for retail, hospitality and food service; kitchen and bath cabinetry; case goods; recreational vehicle and manufactured housing interiors; and flooring – including the luxury vinyl tiles that are so popular today.

Rosetta Stone Inc. (NYSE: RST)- Rosetta Stone Inc. provides technology-based learning products in the United States and internationally. It operates through two segments, Enterprise & Education and Consumer. The company develops, markets, and supports a suite of language-learning, literacy, and brain fitness solutions consisting of software products, Web-based software subscriptions, online and professional services, audio practice tools, and mobile applications. The company offers its courses in 30 languages under the Rosetta Stone, The Blue Stone Logo, Livemocha, Lexia Learning, Lexia, and Fit Brains brands. Rosetta Stone Inc. sells its products and services through call centers, Websites, third party e-commerce Websites, home shopping networks, consignment distributors, select retail resellers, daily deal partners, and third-party resellers, as well as directly to individuals, educational institutions, corporations, and government agencies.

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Best Idea Profile: **Mitel Networks Corporation (Nasdaq: MITL)**

DESCRIPTION:

Headquartered in Ottawa, Canada, by market share, Mitel Networks is the largest provider of communications networking equipment for enterprise customers in Europe and the fourth largest globally. The Company is transitioning from a provider of premises equipment, that has long upgrade cycles, to a recurring revenue model based on pay-as-you-go cloud subscription services. With more than 2.2 million cloud-based users, Mitel is by far the market leader in this space.

Mitel is segmented into three divisions. The Cloud and Enterprise divisions are both related to enterprise communications. Last year, the company added a third division, Mobile networking, through its acquisition of Mavenir.

1 - Enterprise Division – 68% of revenue with flat to slightly decreasing revenue. This is the on-premises based business that is in secular decline as increasingly business customers are looking for cloud based solutions. Nevertheless, this segment is a highly profitable cash cow for Mitel and should continue to provide a stable base of revenue and profit for the foreseeable future. This division sells and supports IP-based telephone platforms, desktop devices, in-building mobile devices, unified communications and contact center applications that are primarily deployed on the customer's premises, or in a private cloud.

2 - Cloud Division - 16% of Revenue, growing at more than 20%. Instead, of using on-premises hardware, Mitel offers the same types of unified communications applications through a cloud-based subscription service.

3 - Mobile Division – 16% of revenue growing at more than 35%. Software-based solutions that enable mobile carriers to offer applications such as group text messaging, multi-party voice or video calling, as well as next generation voice services including Voice over LTE (VoLTE) and Voice over Wi-Fi (VoWi-Fi). The mobile division's solutions are sold to more than 130 mobile service providers, including more than half of the top 20 mobile carriers

Mitel Networks Corporation (Nasdaq: MITL)
Investment Data (as of 11/30/16)

Recent Price	**$7.25**
52-Week Range	$5.81 - $8.82
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	122 M
Average Trading Volume (3 mos)	326,000
Market Capitalization	$884M
Cash	$73M
Long-term Debt	$587M
Enterprise Value (EV)	$1.4 B
TTM Revenue	$1.2 B
EV/ Revenue	1.2x
TTM Adjusted EBITDA	$149 M
EV/ EBITDA	9.4x
2016 EPS (consensus est.)	$0.62
P/E	11.4
Book Value Per Share	$4.57

Founded in the 1970's the Company has a large global footprint connecting 60 million business users in more than 100 countries. The Company has more than 2,500 channel partners and 4,400 employees.

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KEY INVESTMENT CONSIDERATIONS:

Proven Leader with proven track record and vision

CEO since 2011, Richard McBee has put in place a strategy to consolidate the highly fragmented unified communications industry, augmented by organic growth. McBee has 25 years of IT and telecom experience and was previously President of the Communications & Enterprise Group of Danaher Corp. McBee's experience at Danaher, which is well known as an efficient consolidator, has served him well at the helm of Mitel.

The Company has made a half dozen M&A transactions during McBee's tenure and demonstrated its ability to create significant synergies. M&A and organic growth have doubled the size of the company. Management has also been cautious not to overpay for deals. Rather than overpay, management has walked away from the proposed acquisitions of ShoreTel and Polycom, which is reflective of management's M&A discipline.

M&A track record

Aastra Technologies – The Company acquired Astra for CAD $600 million in Jan of 2014. The acquisition of Aastra was highly complementary to Mitel and gave it significant efficiencies of scale. Post combination, the company has the #1 market share in Western Europe and the #3 share in North America. The combination has also delivered $75 million in acquisition synergies from a combination of improved gross margin and cutting redundant operating expenses. Since the acquisition, combined gross margins have improved by approximately four percentage points.

Mavenir – Mitel paid $545 million to acquire Mavenir in 2015. With a completely different customer base and go to market channel, this acquisition is far different that the traditional consolidation play like Aastra. Mavenir added a rapidly growing mobile infrastructure business that is software-based. The Mobile business has grown 35% year to date and is well positioned to grow as mobile carriers increasingly roll out next generation voice services such as VoLTE and VoWifi, as well as over the top messaging services. While this acquisition is less about cost synergies, management expects to gain $23 million in savings by 2017. By integrating Mitel's unified communications and Mavenir's mobile technologies, Mitel also has the potential to offer a seamless mobile unified communications experience for enterprise customers, as well as enable wireless operators to deliver complete business communications.

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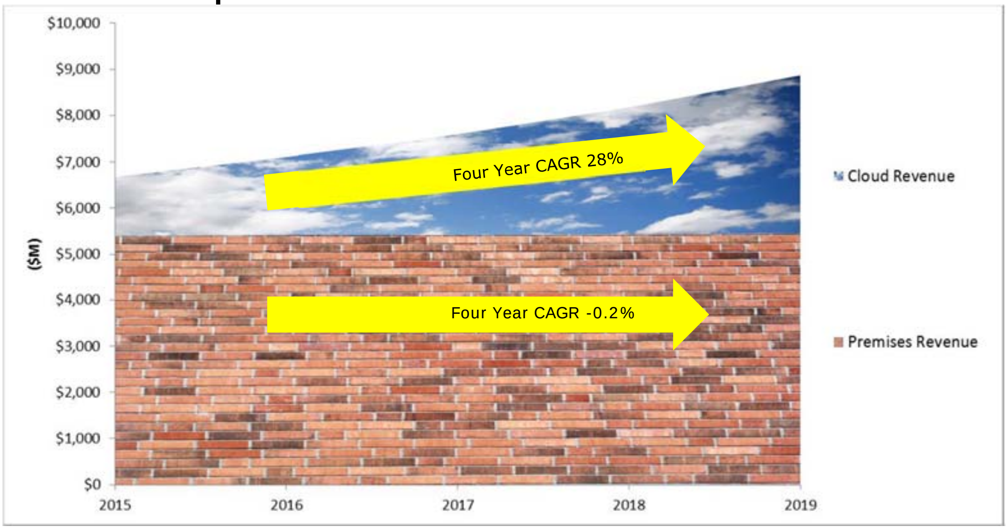
Key Trends driving growth

The transition from customer premises to cloud based unified communications



The chart above is from ShoreTel's (Nasdaq: SHOR) investor slide deck and shows the planned growth of Cloud revenue relative to premises based equipment revenue from 2015 to 2019. By delivering unified communications systems via the cloud, businesses eliminate infrastructure cost and can manage their systems on a centralized basis which lowers their maintenance costs and allows more seamless upgrades and application integration. While clearly cloud is gaining in popularity relative to premises based equipment, there are still many customers in certain industry verticals that will prefer to maintain their own equipment, or deploy a private cloud. Mitel offers four separate paths to upgrading to the cloud. 1) The private cloud allows some enterprise customers, such as large enterprises and government entities that are focused on high levels of security and control, to build their own private cloud using Mitel's solutions. 2) The hybrid cloud is a strategy that allows medium to large enterprises to leverage the investment in existing infrastructure and slowly migrate users to the cloud. 3) The public cloud is the primary deployment for small businesses. 4) The mobile cloud enables enterprise customers to use unified communication applications over mobile networks. Having these four paths is a compelling value proposition for customers, but also allows Mitel to go after customers of all sizes with varying requirements.

Compelling economic model - While there is less up front revenue, once the scale of users reaches critical mass, the economic value of a subscription, or cloud-based, user is far superior to that of a premise-based user. Based on Shortel's investor presentation, lifetime revenue is 7x greater and contribution margin is 4x greater for a cloud-based user. Mitel has reached critical mass of users and has begun producing positive contribution margin from its base of cloud users. Management expects the cloud business EBITDA margin to expand from breakeven to more than 10% over the next two years.

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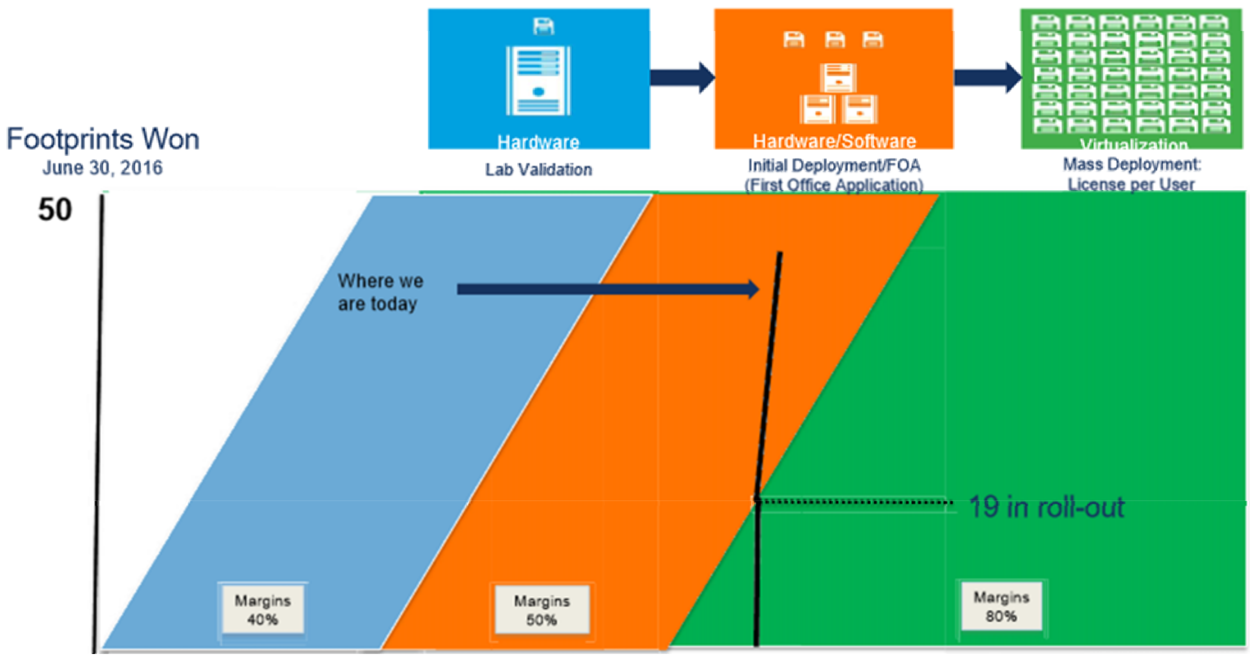
Next generation voice, video and messaging services over VoLTE and VoWifi

Mobile carriers are increasingly looking to deploy voice, video and messaging services over LTE or Wifi Networks. By using these IP based networks, mobile carriers gain efficiency, increase network capacity and can introduce new rich communications services including video, voicemail, real time language translation, instant messaging and video calling.

Market acceleration - According to Deloitte, 100 carriers worldwide will be offering at least one packet-based voice service at the end of 2016, a 2x expansion from the end of 2015 and a 6x expansion from the beginning of 2015. Mitel has won business from 50 plus carriers, including several tier ones. The Company expects 25 of these carriers to move towards network-wide launch by the end of 2016, up from 6 at the end of 2015.

Gaining critical mass will lead to significant margin expansion – The image below is from Mitel's slide presentation and illustrates how margins can expand as customer wins turn into widespread deployment. Management expects EBITDA margins to expand from mid-single digits to 23-24% of sales by calendar 2018.



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Valuation

(In $Millions)	2015*	2016*	2017	2018
Enterprise Division Revenue	870	809	768	730
Growth Rate		-7%	-5%	-5%
Cloud Division Revenue	156	187	225	270
Growth Rate		20%	20%	20%
Mobile Division Revenue	164	197	236	283
Growth Rate		20%	20%	20%
Total Revenue	**$1,190**	**$1,193**	**$1,229**	**$1,283**
Revenue Growth		**0.3%**	**3.0%**	**4.4%**
Enterprise Division EBITDA		137	138	139
EBITDA Margin		17%	18%	19%
Cloud Division EBITDA		7	13	27
EBITDA Margin		4%	6%	10%
Mobile Division EBITDA		14	33	65
EBITDA Margin		7%	14%	23%
Total EBIDA	**$147**	**$159**	**$185**	**$231**
EBITDA Margin	**12.4%**	**13.3%**	**15.0%**	**18.0%**
Cash	92	75	75	75
Fee Cash Generation		75	75	90
Debt	645	587	512	422
Enterprise Value		1,382	1,609	2,009
Market Cap		870	1,172	1,662
EV/EBITDA		8.7	8.7	8.7
Shares Outstanding		126	126	126
Share Price		**$6.90**	**$9.30**	**$13.19**

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

- **Revenue Growth –** Over the next four years, we have followed management's estimates for growth in each of the three divisions. Twenty percent growth in both the Cloud and Mobile divisions will be offset by mid-single-digit decline in the Enterprise division, leading to low-single-digit growth overall.
- **EBITDA Margins –** We are also following management's targeted model for margin improvement in the cloud and mobile divisions. As described previously, the cloud division has significant operating leverage and the Mobile division's revenue mix will increasingly have a higher concentration of high-margin software sales. We are straying from the Company's margin targets for the enterprise division. Margin improvement in the enterprise division has been positive, but less than expected. Over the next few years, we more conservatively model one percentage point of improvement annually.
- **Free Cash Flow –** We assume that approximately 40% of EBITDA will translate into Free Cash Flow and be used to repay outstanding debt.
- **Valuation –** Based on our EBITDA growth assumptions and applying the current EV/EBITDA multiple of just under 9x, we believe shares could have 90%+ upside during the next two years. As the company's business model shifts from one-time lumpy sales to more recurring and predictable revenue, we believe the price multiple could expand by a few turns, which would provide further upside.

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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	$12.29	46.5%	22.6%	23.9%
New Gold (NYSE: NGD).	31-Oct-15	$2.47	$3.69	49.4%	14.3%	35.1%
Townsquare Media (NYSE: TSQ)	30-Nov-15	$11.43	$8.80	-23.0%	10.9%	-33.9%
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	$11.72	$14.60	24.6%	17.0%	7.6%
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	$62.18	$72.27	16.2%	28.3%	-12.1%
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	$21.54	$32.00	48.6%	28.3%	20.3%
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	$1.66	$2.75	65.7%	19.2%	46.5%
PAR Technology Group (NYSE: PAR)	30-Apr-16	$6.39	$5.33	-16.6%	17.5%	-34.1%
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	$1.60	$1.91	19.4%	15.1%	4.3%
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	$7.99	$11.50	43.9%	15.1%	28.9%
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	$14.28	$20.62	44.4%	9.1%	35.3%
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	$11.12	$15.00	34.9%	6.6%	28.3%
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	$22.51	$23.11	2.7%	6.6%	-3.9%
Northwest Pipe Co. (NWPX)	31-Oct-16	$13.16	$18.40	39.8%	11.5%	28.3%
			Average	**28.3%**	**15.9%**	**12.5%**

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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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