

Mossberg's Investor Digest

From the Editor...

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

This month's issue highlights 100+-year-old **Northwest Pipe Co. (NWPX)**, which is the largest manufacturer of engineered steel pipe in North America with a 45% market share. The company large diameter (18 to 156 inches), high pressure water pipe is used to transport water to treatment plants, as well as pipe used inside treatment plants. Aging infrastructure and population growth has caused a significant need for water infrastructure investment and should provide long-term growth driver for the industry and NWPX.

Due to difficult market conditions in recent years, the company has sustained significant losses. The severity has led management to put a portion of its business that produces more commodity-like pipe up for sale. Similarly, management is rationalizing production capacity and has implemented cost cutting and productivity enhancements to offset weak market conditions.

It appears 2016 will mark the bottom of multi-year weakness in demand and NWPX should be better positioned to return to profitability over the next 18 months. Trading at approximately 60% of book value, the market appears to have oversold shares, which should give decent downside protection should a recovery take longer than expected. Based on our back of the envelope calculations, we believe shares could be worth more than \$21 by 2018, a 60% increase over current levels.

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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...

Repligen Corporation (Nasdaq: RGEN)- Repligen is an innovator and manufacturer of high-value products that enable efficiencies in the production of biologics. We are inspiring advances in bioprocessing through the development and commercialization of high-value products and flexible solutions that address critical steps in the production of biologic drugs, principally monoclonal antibodies. Their business is influenced by the growth in demand for biologic drugs, particularly the global market for monoclonal antibodies (mAbs). Demand for their products is associated with the overall volume of mAbs manufactured; there is little connection to final drug pricing or the clinical or commercial success or failure of an individual biologic drug. They are building the business mainly through organic growth and strategic acquisitions.

Clean Diesel Technologies Inc. (Nasdaq: CDTI) - Clean Diesel Technologies, Inc. are a leading manufacturer and distributor of light duty vehicle catalysts and heavy duty diesel emissions control systems and products to automakers, distributors, integrators, and retrofitters in the United States, Canada, Sweden, and the United Kingdom. Their business is driven by increasingly stringent global emission standards for internal combustion engines, which are major sources of a variety of harmful pollutants. Their solutions significantly reduce four of the principal, harmful emissions formed by the combustion of fossil fuels and biofuels.

NCI, Inc. (Nasdaq: NCIT)- NCI is a leading provider of enterprise solutions and services to U.S. defense, intelligence, health care and civilian government agencies. They have the expertise and proven track record to solve their customers' most important and complex mission challenges through technology and innovation. NCI focuses on delivering cost-effective solutions and services in the areas of agile software application and systems development/integration; cybersecurity and information assurance; engineering and logistics support; enterprise information management and advanced analytics; cloud computing and IT infrastructure optimization; health IT and medical support; IT service management; and modeling, simulation and training.

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Best Idea Profile:

Northwest Pipe Co. (NWPX)

DESCRIPTION:

100+-year-old **Northwest Pipe Co. (NWPX)** is the largest manufacturer of engineered steel pipe in North America with a 45% market share. The company has two divisions. 1) The **Water Transmission Group** specializes in large diameter (18 to 156 inches), high pressure water pipe used to transport water to treatment plants, as well as pipe used inside treatment plants. This is not the more commodity-type smaller diameter pipe that delivers water directly into households. 2) **The Tubular Products Group** manufactures smaller diameter pipe used for applications in the energy, commercial and industrial sectors. Due to difficult market conditions, both groups have been under pressure, resulting in significant losses for the last several years. The severity has led management to idle the Tubular Products Group and put its assets up for sale. Similarly, management is rationalizing production capacity and has implemented cost cutting and productivity enhancements in the Water Transmission group to offset weak market conditions.

It appears 2016 will mark the bottom of multi-year weakness in demand and the company should be better positioned to return to profitability over the next 18 months. Trading at approximately 60% of book value, the market appears to have oversold shares, which should give decent downside protection should a recovery take longer than expected.

Headquartered in Vancouver, Washington, the company has eight manufacturing facilities in the United States and Mexico. The Company employs about 650 employees, approximately 90% of which are located in the United States.

Northwest Pipe Co. (NWPX) Investment Data (as of 10/26/16)

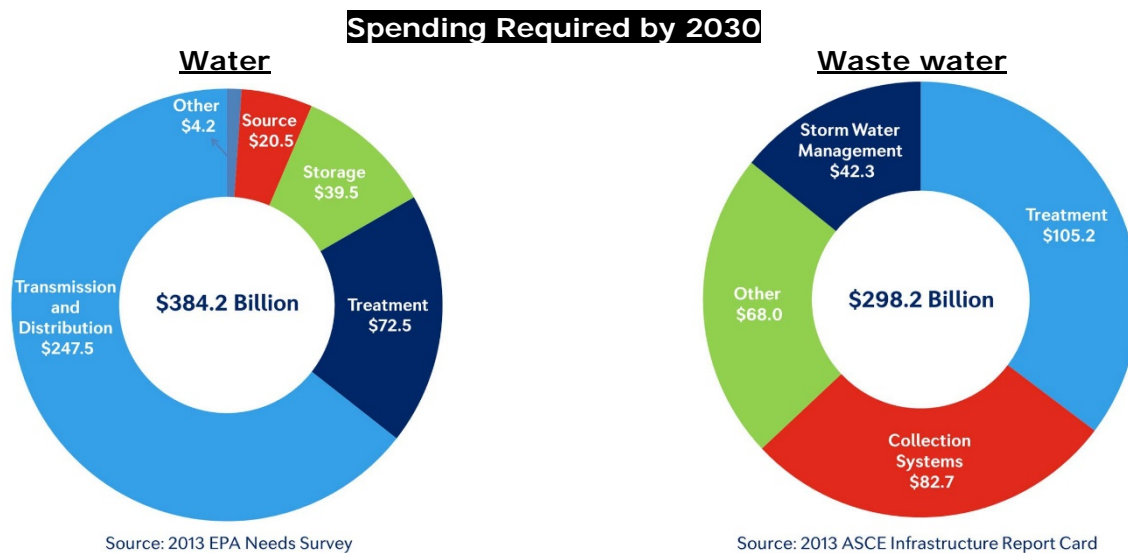
Recent Price	\$13.16
52-Week Range	\$7.46 - \$15.23
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	9.6 M
Average Trading Volume (3 mos)	33,000
Market Capitalization	\$126M
Cash	\$9M
Long-term Debt	\$1M
Enterprise Value (EV)	\$119MM
TTM Revenue	\$174MM
EV/ Revenue	0.6x
TTM Adjusted EBITDA	(\$31 M)
EV/ EBITDA	10.6x
Book Value Per Share.	\$21.02

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KEY INVESTMENT CONSIDERATIONS:

Spending on water infrastructure market to drive long-term growth

Spending is critical over next 5 to 25 years to keep water safe – According to the American Society of Civil Engineers, the U.S. drinking water and wastewater infrastructure receives a grade of “D” for now. Without a significant uptick in spending, it’s likely the grade will change to an “F”. The EPA estimates the nation will need to spend \$384 billion over the next 20 years to ensure that drinking water standards are in compliance with the Safe Drinking Water Act. Another \$298 billion in wastewater investments over the next 20 years are required to address water-related health problems and ensure that watersheds are compliant with the Clean Water Act.



- **Population is outgrowing current infrastructure** – The U.S. population is expected to grow 12% by 2030 and 24% by 2050. According to the American Water Works Association, over the next 40 years, the need for water infrastructure spending will exceed \$1.7 trillion, with replacement accounting for 54% of the total spend, and population growth accounting for the remaining 46%.
- **The current infrastructure is old and needs replacement** - Significant portions of many municipal water systems are 40 to 50 years old, and are nearing the end of their useful lives. Without renewal/replacement of existing systems, pipe classified as poor, very poor or life elapsed will increase from 10% of pipes in the U.S. to 44% by 2020
- **Current water supply sources are being exhausted** - The development of new sources of water at greater distances from population centers will drive the demand for new water transmission lines.

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Business rationalization to drive greater returns

Industry conditions for the past three years have been very difficult for Northwest Pipe and other industry participants. Lack of spending from small municipal markets, along with the additional market capacity has led to a weak pricing environment and in the past year and even negative gross margin performance. However, NWPX and others have recently removed production capacity, and there appears to be an uptick in demand beginning at the end of 2016/ beginning of 2017. At the same time, the company has taken several steps to rationalize its infrastructure, divest non-strategic businesses and lower its cost structure, all of which should position the company to return to profitability as market conditions improve.

Exploring the sale of the Tubular Products Group - In mid-2015, the company hired JP Morgan and announced that it was exploring the sale of its Tubular Products Group. Since the announcement, the company has idled its plant in Atchison Kansas and sold its remaining inventory. This business segment, which had represented about one third of overall sales, suffered a severe revenue decline due to deteriorating pricing environment, as well as a sharp falloff in O&G drilling activity. While the company has disclosed very little related to the possible sale, the fixed assets of this group are on the balance sheet at a value of \$37.2 million. The tax assessed value for the land and building are \$1.3 million. Given the depressed state of this market, it is likely that the sale will yield only a fraction of the fixed asset investment and will take some time to complete. It is important to put into perspective that the book value per share of the Tubular Products Group is just under \$4 per share, which represents about 17% of total book value. By comparison, the stock is trading at a 40% discount to book value.

Sale of Denver property – Earlier this month, NWPX announced the sale of its Denver facility for \$14.4 million. The sale should yield a gain of approximately \$7 million and will remove 20% of the Company's water pipe production capacity.

Cost cutting initiatives – Management has also significantly cut costs by improving efficiencies and lowering the headcount. In the past year, headcount was reduced by 35%, including headcount reductions in its corporate and water transmission groups, as well as the idling of production at its Tubular Products Group. In addition, productivity has also improved. According to management, the company is producing similar volume to that of 2008, but using 45% less people. Volume per employee as has improved 31% since 2014. Likewise, SG&A costs have been reduced from \$24 million in 2014, \$22 million in 2015 and are expected to at a run rate of \$18 million at the end of 2016.

Water infrastructure pipe market growth over next three years

According to the Company's annual meeting presentation, the demand for water infrastructure pipe should grow by 70% over the next three years. Management believes the addressable market for its products will total approximately \$1.2 billion over the next three years.

Water Infrastructure Pipe tons produced/ projected

2014	2015	2016	2017	2018
125,700	126,300	181,100	197,400	215,100

Change of Control amendments

On August 1, 2016, the Company amended its change in control provision in the employment agreements with its senior executives. While I try not to read too much into this, when companies put themselves up for sale, this is a common housekeeping item utilized to incentivize management not to exit prior to a sale. I also try to not make an investment thesis based on a potential sale, but it does provide an additional piece of the mosaic.

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Valuation

	In (\$mm)	Per Share
Tangible Equity Value (June 30, 2016)	201.7	21.01
Less asset Value of Tubular Products	-36.7	-3.82
Estimated Proceeds from sale of Tubular Products (@20% of asset Value)	7.3	0.76
Gain on sale of Denver Facility	6	0.63
Tangible Book Value	178.3	\$ 18.58

The table above shows our estimate of tangible book value following the sale of the Denver property and assumes the sale of the Tubular Products Group. We assume a sale price that is the equivalent of 20% of the Tubular Products Group's assets value as of June 30, 2016, which we believe is conservative. Post rationalization, we estimate a tangible book value of \$18.58 per share, which is 40% above the current stock price. Based on this, we believe the current valuation offers significant downside protection.

	2017	2018
Projected Volume (In Tons)	197,400	215,100
Market Share	45%	45%
Volume	88,830	96,795
Revenue Per Ton	2,050	2,100
Revenue	182,101,500	203,269,500
Gross Margin	12%	15%
Gross Profit	21,852,180	30,490,425
Operating Expenses	18,000,000	19,000,000
Operating Profit	3,852,180	11,490,425
Tax	0	0
Net Income	3,852,180	11,490,425
Shares	9,600,000	9,600,000
EPS	\$0.40	\$1.20

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 market volumes and assumed a constant market share of 45%, along with a modest price increase.
- **Gross Margins** – Based on productivity improvements and a more rational market environment, we expected gross margins will return to historical levels by 2018.
- **Operating expenses** – We base 2017 operating expenses based on the run rate exiting 2016 and add \$1 million in additional expenses for 2018. The increase in expenses equates to 5.5% growth, which is approximately half of the 11% growth rate of the top line, and reflects the operating leverage in the business.
- **Taxes** – We assume no taxes due to tax loss carry forwards.
- **Valuation** – Based on a high-teens multiple (17x to 18x) of 2018 EPS, we believe shares could be worth more than \$21 by 2018, a 60% increase over current levels.

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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 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. Date	Relative Perf. vs. Russell 2000
M/A-Com Technology Solutions Holdings, Inc. (NASDAQ:MTSI)	28-Mar-15	\$35.81	\$38.17	6.6%	-1.4%	8.0%
Kimball International, Inc. (NASDAQ:KBAL)	30-Apr-15	\$9.97	\$12.77	28.3%	0.2%	28.1%
Ironclad Performance Wear Corp. (OTC:ICPW)	30-May-15	\$0.27	\$0.23	-15.2%	-1.9%	-13.3%
Customers Bancorp, Inc. (NYSE: CUBI)	30-Jun-15	\$26.87	\$25.86	-3.8%	-2.5%	-1.3%
Potbelly Corporation (NASDAQ: PBPB)	30-Jul-15	\$13.43	\$13.40	-0.2%	-0.8%	0.5%
Cosi Inc. (NASDAQ:COSI)	31-Aug-15	\$1.17	\$0.03	-97.4%	5.4%	-102.9%
Calloway Golf Company (NYSE: ELY).	30-Sep-15	\$8.39	\$10.58	26.3%	11.1%	15.3%
New Gold (NYSE: NGD).	31-Oct-15	\$2.47	\$4.13	67.8%	5.2%	62.6%
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$8.90	-22.1%	2.0%	-24.2%
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$10.70	-8.7%	7.6%	-16.3%
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$84.77	36.7%	18.1%	18.6%
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$31.83	47.8%	18.3%	29.5%
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$2.09	26.5%	9.7%	16.8%
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$5.26	-17.7%	8.1%	-25.8%
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$1.64	2.5%	6.3%	-3.8%
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$11.96	49.7%	6.1%	43.5%
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$19.97	40.1%	0.2%	39.9%
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$10.53	-5.3%	-1.4%	-3.9%
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$19.01	-15.0%	-2.3%	-12.7%
				Average	7.7%	4.6%
						3.1%

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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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