

Mossberg's Investor Digest

From the Editor...

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Headquartered in Houston, TX, 33-year-old **NCI Building Systems, Inc. (NYSE: NCS)** is a leading designer and manufacturer of metal buildings and metal building components for low-rise (1-to-5 stories) structures (i.e. offices, banks, warehouses, hangers, churches, schools, hospitals, etc.) primarily used in commercial and industrial markets.

We expect revenue for the next three years will grow in the mid-single digits, which is supported by what is likely to be a continuation in the cyclical recovery, combined with secular growth in metal building construction and the growth of the Company's Insulated Metal Panel business.

Enterprise value is currently 8.7x the mid-point of management's 2017 EBITDA guidance. Conservatively, we believe the company will be able to sustain this valuation multiple over the next three years and believe there is potential for upside of at least one turn to valuation. Our back of the envelop model yields a valuation of \$22 in two years and nearly \$26 in three, which equates to 43% and 66% increases, respectively.

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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...

Castle Brands Inc. (NYSE: ROX) – Castle Brands develops and markets premium and super premium brands in the following beverage alcohol categories: rum, whiskey, liqueurs, vodka and tequila. They distribute their products in all 50 U.S. states and the District of Columbia, in thirteen primary international markets, including Ireland, Great Britain, Northern Ireland, Germany, Canada, South Africa, Bulgaria, France, Russia, Finland, Norway, Sweden, China and the Duty Free markets, and in a number of other countries in continental Europe and Latin America.

KMG Chemicals, Inc. (NYSE: KMG)- KMG is the leading global supplier of high purity process chemicals, serving major semiconductor manufacturers in the U.S., Europe and Asia. KMG formulates and blends acids, solvents and other wet chemicals used to etch and clean silicon wafers in the production of semiconductors, photovoltaics (solar cells) and flat panel displays.

Venator Materials PLC (NYSE: VNTR)- Venator Materials manufactures and markets chemical products worldwide. It operates through two segments, Titanium Dioxide and Performance Additives. The Titanium Dioxide segment offers titanium dioxide (TiO₂), such as rutile, anatase, and nano TiO₂ products for use in coatings, plastics, paper, printing inks, fibers, and food and personal care products. The Performance Additives segment provides barium and zinc additives for use in coatings, films, pharmaceuticals, and paper and glass fiber reinforced plastics; colored inorganic pigments comprising iron oxides, ultramarines, specialty inorganic chemicals, and driers for construction, coating, plastic, and specialty markets; and wood protection chemicals for use in residential and commercial applications, as well as water treatment chemicals.

Limoneira Company (Nasdaq: LMNR) – Limoneira is an agribusiness and real estate development company founded and based in Santa Paula, California, committed to responsibly using and managing approximately 7,300 acres of land, water resources and other assets to maximize long-term stockholder value. Their current operations consist of fruit production and marketing, real estate development and capital investment activities.

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Best Idea Profile:

NCI Building Systems, Inc. (NYSE: NCS)

DESCRIPTION:

Headquartered in Houston, TX, 33-year-old **NCI Building Systems, Inc. (NYSE: NCS)** is a leading designer and manufacturer of metal buildings and metal building components for low-rise (1-to-5 stories) structures (i.e. offices, banks, warehouses, hangers, churches, schools, hospitals, etc.) primarily used in commercial and industrial markets.

The Company breaks its revenue into three vertically integrated market segments:

- 1) **Metal Coil Coatings** (\$107MM, ~5% of total revenue) – The product in this segment includes flat-rolled metals that are cleaned, treated, painted, slit, and/or embossed and then rolled into large coils. About 50% of the Company's production capacity is used internally, and the remaining capacity supplies metal coils to other manufacturers of metal buildings and metal building components, as well as other third parties who supply coils for other uses such as lighting fixtures, ceiling grids, water heaters, appliances and other applications.
- 2) **Metal Components** (\$926MM, ~55% of total revenue) Products in this segment include essentially all the products and parts that a contractor might buy to assemble a building such as metal roofs and wall panels, secondary structural framing, doors, metal partitions, metal trim and other related accessories. Approximately 14% of the components produced are used internally in the Company's Engineered Buildings Systems segment and the remaining 86% are sold externally to contractors, or end users for use in new construction of metal buildings, as well as parts for use in the maintenance and repair of existing buildings.
- 3) **Engineered Building Systems** - (\$652MM, ~40% of total revenue) This segment includes the sale of building frames and entire buildings that are custom designed, engineered and manufactured to meet building codes and other end-user requirements, and then shipped to the customer site ready for assembly.

NCI Building Systems, Inc. (NYSE: NCS) Investment Data (as of 10/30/17)

Recent Price	\$15.65
52-Week Range	\$13.05 - \$18.60
Fiscal Year End	October
Dividend	N/A
Yield	N/A
Shares Outstanding	70.9 M
Average Trading Volume (3 mos)	630,000
Market Capitalization	\$1.1 B
Cash	\$46 M
Long-term Debt	\$388 M
Enterprise Value (EV)	\$1.5 B
TTM Revenue	\$1.8 B
EV/ Revenue	0.8x
FY18 EPS (consensus est.)	\$1.05
P/E	14.9x
FY17 EBITDA Guidance	~\$165 M
EV/EBITDA	9.1x
Book Value Per Share	\$2.17

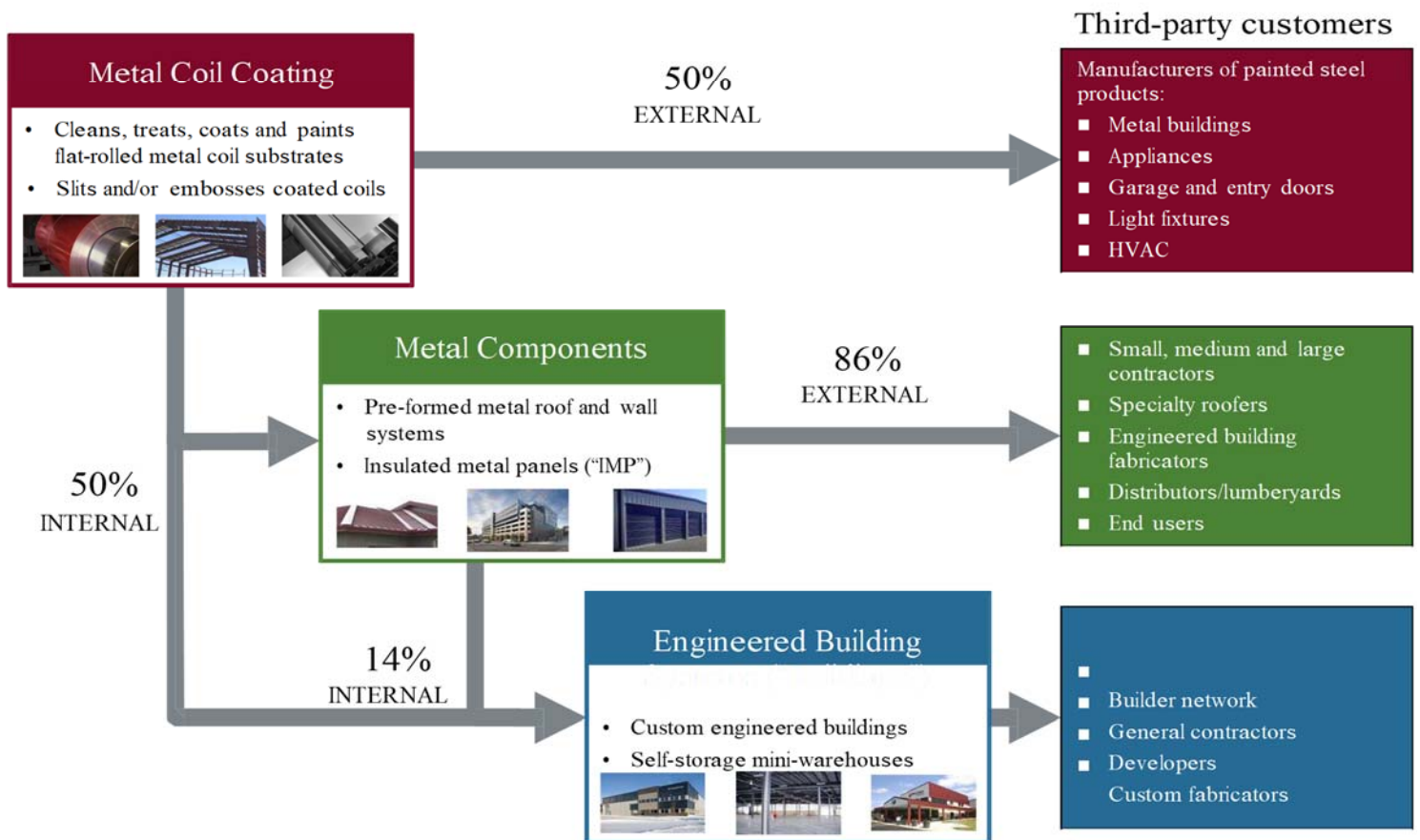
The Company sells direct to a large network of 3,200 authorized building contractors, 1,000 insulated metal panel dealers and 5,500 architects.

The Company employs approximately 5,500 employees at its 38 manufacturing facilities located in the United States, Mexico, Canada and China and its sales and distribution offices throughout the U.S. and Canada.

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KEY INVESTMENT CONSIDERATIONS:

Vertical Integrated Business



Source: Company Presentation

As shown in the chart above from the Company's investor presentation, the three business segments are vertically integrated and benefit from using the similar raw materials of metal coil coating. Benefits for vertical integration include:

- **Greater efficiencies from increased asset utilization** – Excess capacity from the coil coating and metal components business can be used to produce products for third parties. Increasing plant utilization provides for greater consistency and lower per unit production costs
- **Better and more reliable service** – Vertical integration gives the Company greater control over its supply chain and means the Company is less effected by supplier shortages, or delays. This means NCI has greater control over committing and delivering to its customers on time. This aspect is important to contractors that are often on strict timelines and provides significant differentiation for NCI. In turn, this differentiation allows NCI to maintain price, or even charge premium prices in competitive situations.
- **Lower Costs** – Vertical integration allows the company to capture "middle man" costs and gives the company buying power to negotiate lower prices for raw materials. Also, having greater control over the supply chain, allows the company to have less safety stock and lower overall inventory levels.

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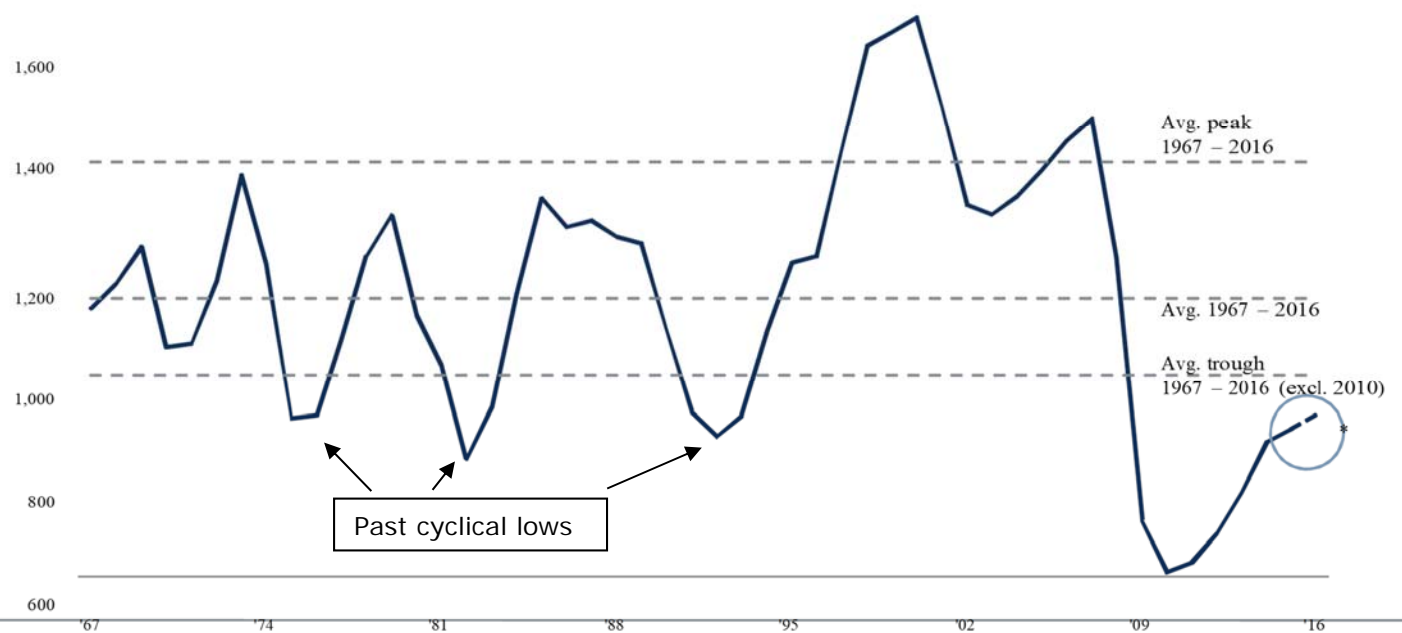
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Early stages of cyclical recovery

New nonresidential starts – low-rise (5 stories or less)⁽¹⁾

(Sq. ft. in millions)

(Sq. ft. in millions)		Sq. ft.	2016	Sq. ft. difference	Percentage difference
Low-rise nonresidential starts ⁽¹⁾					
Average trough 1967	2016 (ex. 2010)	995	916	79	9%
Average 1967	2016	1,146	916	230	25%
Average peak 1967	2016	1,414	916	498	54%



Source: Company Presentation

Nonresidential construction recovery will lag residential - As shown in the chart above from the Company's investor presentation, nonresidential construction has recovered, but is still slightly below the low point for low-rise construction starts typically reached during previous cycles.

Reversion to the mean implies 25% growth potential for low-rise nonresidential housing starts - The data in the chart above implies that in 2016, housing starts were still 25% below the average starts over the past 50 years.

Leading indicators call for low single digit growth in 2017 - Growth in non-residential construction is highly correlated to several leading indicators including the American Institute of Architects' Architecture Mixed Use Index, single family starts, the Conference Board Leading Economic Index, and industrial vacancy rates. While there is typically a 9- to 14-month lag in the nonresidential activity, these indicators have shown significantly positive trends in the last two years and indicate continued strength in nonresidential construction is likely.

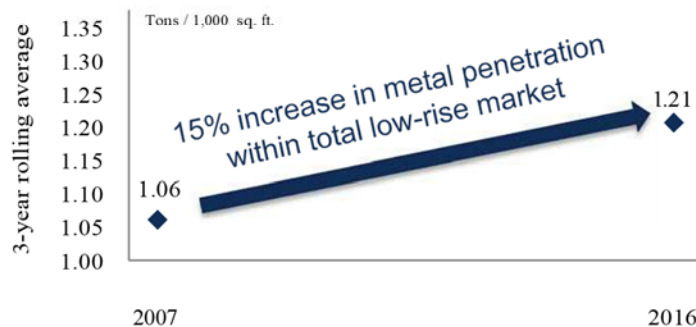
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Secular growth of metal construction

MBMA tons shipped / low-rise nonres. construction starts⁽¹⁾

Metal building industry has gained share in the low-rise nonresidential construction market



Source: Company Presentation

Metal Construction is taking market share – According to the chart above, metal construction increased 15% in the past ten years in terms of tonnage used per square foot of nonresidential construction. Metal products in new construction and repair and retrofit markets are gaining share due to increasing acceptance and recognition of their benefits including:

- **Lower cost roofing** - While the cost of metal roofing is greater, the total lifetime costs are lower than that of conventional roofing systems for both new construction and retrofit roofing. Metal roofing systems generally last for a minimum of 20 years without requiring major maintenance or replacement, versus five to ten years for conventional roofs.
- **Longer lasting** - Relative to wood frame construction, metal is not susceptible to deterioration from cracking, rotting or insect damage.
- **Less labor costs** - Buildings that are manufactured in a factory allow for automation and/or the substitution of less expensive factory labor for skilled on-site construction labor otherwise required for traditional building methods.
- **Attractive aesthetics and flexibility** - Metal roofing allow architects and builders to create distinctive looks relative to conventional roofing material. Also, during construction, or after the building is completed, an engineered building can easily and economically be expanded by removing the end or side walls and erecting new framework.
- **Shorter construction time** - It takes less time to construct an engineered building than other building types. Since most of the work is done in the factory, there is also less likelihood of weather interruptions.
- **Environmentally friendly**. Metal buildings utilize between 30% and 60% recycled content. The Company also applies highly reflective paint for roofing and siding, which helps conserve energy and operating costs.

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Successful commercialization of Insulated Metal Panels (IMP) to provide above market growth

As its name implies, Insulated Metal Panels (IMP) provide both high-performance insulation within the interior/exterior of wall structures. The company has applied a dedicated growth strategy to this area and successfully grown IMP sales from \$30 million in 2011 to \$439 million during the trailing twelve months ended in the third quarter. Growth Drivers for this business include:

- Stricter building codes in numerous states
- High-end aesthetic appeal
- Among the lowest installed cost
- Ease of installation
- Energy efficiency

Lots of room for growth – IMP market penetration is only 3% in North America, which is only 1/5 of the penetration level reach in Europe.

Improving Cost efficiencies

The Company has implemented plans to improve cost efficiency and optimize its manufacturing plant footprint, which includes 38 manufacturing facilities located in the United States, Mexico, Canada and China. Management expects to complete the implementation by the end of 2018 and achieve \$30 million to \$40 million in annual cost savings. Plans include:

- **Facilities Rationalization** – The Company has closed 5 facilities since the beginning of fiscal 2016 and consolidated those operations into other manufacturing plants.
- **Increasing the use of advanced manufacturing** – The Company plans to invest an incremental 1.5% to 2% of CAPEX to fund equipment that will allow for greater use of automation and less labor-intensive functions. In particular, more automation will be used in the manufacturing of frames, trims and doors. In addition to cost improvement, management expects to see improvements in quality and greater flexibility to scale up or scale down as market conditions merit.
- **Implementing continuous improvement programs** – In the past quarter, the company has trained more than 100 of its staff how to implement lean, six sigma processes. Efforts are focused on the commercial side of the business and the back office, with plans to consolidate back office functions.

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Valuation

Sum of the Parts is Greater than the Whole

	2016	2017	2018	2019	2020
Revenue Growth		5%	5%	5%	5%
Revenue	1,685	1,766	1,854	1,947	2,044
EBITDA	166	165	185	204	225
EBITDA Margin	9.9%	9.3%	10.0%	10.5%	11.0%
Cash for Share Repurchase			50		
Free Cash Flow			15	65	65
Cash		45	45	45	45
Debt		387	372	307	242
Enterprise Value		1,442	1,621	1,787	1,965
EV/ EBITDA		8.7	8.7	8.7	8.7
Market Capitalization		1,100	1,294	1,525	1,768
Share Count		71.0	69	69	69
Market Price		15.55	18.88	22.26	25.81

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

- **Revenue growth** – We expect revenue for the next three years will grow in the mid-single digits (5%). Our assumption is supported by what is likely to be a continuation in the cyclical recovery, combined with secular growth in metal building construction and the growth of Insulated Metal Panel business.
- **EBITDA margin** – Our model assumes EBITDA margins will grow to approximately 11% of sales, which is consistent with historical rates, as well as the cost efficiency plans the company has put in place.
- **Share Repurchases** – We assume the company will utilize its recent share authorization to repurchase \$50 million of shares during next fiscal year. We conservatively estimate this will reduce the share count by 2.5 million.
- **Free Cash Flow** – We conservatively estimate that the company will produce \$65 million in free cash flow per year during the next three years. This is consistent with the average free cash flow generated over the past two years and, on average, should prove conservative given the plans for growth in profitability. We expect the company will use the balance of free cash flow, after stock repurchases, to reduce debt levels.
- **Valuation Multiple** – Enterprise value is currently 8.7x the mid-point of management's 2017 EBITDA guidance. Conservatively, we believe the company will be able to sustain this valuation multiple over the next three years and believe there is potential for upside of at least one turn to valuation.
- **40% upside in the next two years.** Working backwards from enterprise value, our back of the envelop model yields a valuation of \$22 in two years and nearly \$26 in three, which equates to 43% and 66% increases, respectively.

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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	\$14.40	71.6%	35.5%	36.2%
New Gold (NYSE: NGD).	31-Oct-15	\$2.47	\$3.40	37.7%	28.3%	9.3%
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$10.24	-10.4%	24.4%	-34.8%
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$8.10	-30.9%	31.3%	-62.1%
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$88.73	42.7%	44.0%	-1.3%
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	44.2%	4.4%
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$3.51	111.4%	33.8%	77.6%
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$10.50	64.3%	31.8%	32.5%
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$2.90	81.3%	29.6%	51.7%
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$29.07	263.8%	29.4%	234.4%
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$22.70	59.0%	22.2%	36.8%
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$17.10	53.8%	20.2%	33.5%
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$31.45	39.7%	19.1%	20.6%
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$18.15	37.9%	25.1%	12.8%
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$8.63	19.0%	12.7%	6.3%
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$2.98	-80.5%	9.9%	-90.3%
RadNet, Inc. (Nasdaq: RDNT)	31-Jan-17	\$5.80	\$10.65	83.6%	9.5%	74.1%
Guidance Software, Inc. (Nasdaq: GUID)	28-Feb-17	\$6.60	\$7.10	7.6%	7.5%	0.1%
Calgon Carbon Corporation (NYSE: CCC)	31-Mar-17	\$14.25	\$21.65	51.9%	7.6%	44.4%
LRAD Corporation (Nasdaq: LRAD)	30-Apr-17	\$1.51	\$2.09	38.4%	6.5%	32.0%
Trecora Resources (NYSE: TREC)	31-May-17	\$10.65	\$12.25	15.0%	8.8%	6.2%
EVINE Live Inc. (Nasdaq: EVLV)	30-Jun-17	\$1.00	\$1.14	14.0%	5.3%	8.7%
LSI Industries Inc. (Nasdaq: LYTS)	31-Jul-17	\$8.38	\$6.69	-20.2%	4.6%	-24.8%
Cooper Tire & Rubber Company (NYSE: CTB)	31-Aug-17	\$33.80	\$32.45	-4.0%	6.1%	-10.1%
RealNetworks, Inc. (Nasdaq: RNWK)	30-Sep-17	\$4.78	\$4.79	0.2%	0.0%	0.2%
				Average	39.8%	19.9%

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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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