

# Mossberg's Investor Digest

## From the Editor...

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Headquartered in Seattle, WA, 23-year-old **RealNetworks, Inc. (Nasdaq: RNWK)** invented the streaming media category in the mid-90's with its RealPlayer audio and video streaming service. Since that time, the Company has introduced new services and now breaks its business into three reporting segments: **Consumer Media (20% of revenue)** – The Consumer Media segment includes RealPlayer software which provides consumers with the ability to download and manage media on their PC, as well as mobile devices. This segment also derives revenue from licensing fees for the newly introduced RealMedia high Definition (RMHD) codec that is embedded in chipsets for high definition video playback on phones, laptops, smart TV's etc. **Mobile Services (60% of revenue)** – Revenue from this segment is primarily derived from mobile and online service providers. The Company offers Software-as-a-service (SaaS) that enables providers to offer over-the-top services and intercarrier messaging to more than 700 million mobile handsets worldwide. **Games (20% of revenue)** – Revenue from this segment comes from the sale of casual electronic games, which are offered through app stores, the Company's websites, gamehouse.com and zylom.com, as well as through social networks and other third-party portals.

RealNetworks also owns a 42% stake in music streaming service provider, Rhapsody, which has engaged an investment bank and is likely on the auction block. While comparable valuations are all over the place, comparable music services are being valued at \$200+ per subscriber. That valuation would give Rhapsody a value of \$900 million, which translates into more than \$10 per share for RealNetworks' ownership stake.

Over the next three years, our back-of-the-envelope model produces \$0.30 in earnings. Applying a 25x multiple yields a valuation of \$7.50 per share, more than 50% upside from the recent price. Adding the \$1.70 per share cash, plus the potential valuation of up to \$10 per share for Rhapsody, yields a value that is nearly 4x the current stock price. Even if Rhapsody falls significantly short of the comparable valuation, it appears the current price of the stock represents an attractive risk/ reward.

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## September 2017

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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...

**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.

**AMREP Corporation (NYSE: AXR)** - through its subsidiaries, is engaged in two business segments: real estate and fulfillment services. The real estate business operated by AMREP Southwest Inc. is a major holder of real estate in the City of Rio Rancho, New Mexico and certain adjoining areas of Sandoval County, New Mexico. The real estate business focuses on the entitlement, development and sale of land for residential, commercial and industrial uses. The fulfillment services business operated by Palm Coast Data LLC performs fulfillment and contact center services. The fulfillment services business performs services for consumer publications, trade (business) publications, membership organizations, non-profit organizations, government agencies and other direct marketers.

**Daseke Inc. (NASDAQ: DSKE)** - is a leading consolidator and the largest owner of capacity in the very fragmented \$133 billion flatbed and specialized transportation market, yet accounts for less than one percent market share of this segment. As of September 5, 2017, Daseke grew revenues from \$30 million in 2009 to an approximate pro forma \$869 million in 2016.

**Omega Protein Corporation (OME)** - Omega Protein Corporation is a nutritional ingredient company and the nation's leading vertically integrated producer of omega-3 fish oil and specialty fish meal products. Omega Protein develops, produces and delivers nutritional ingredients throughout the world to three primary industries—human nutrition, animal nutrition and plant nutrition. Founded in 1913 as a commercial fishing operation, Omega Protein's legacy business allowed the Company to become one of the world's leading producers of fish oil and the largest manufacturer of fish meal in the United States.

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Best Idea Profile:

RealNetworks, Inc. (Nasdaq: RNWK)

## DESCRIPTION:

Headquartered in Seattle, WA, 23-year-old **RealNetworks, Inc. (Nasdaq: RNWK)** invented the streaming media category in the mid-90's with its RealPlayer audio and video streaming service. Since that time, the Company has introduced new services and now breaks its business into three reporting segments:

**Consumer Media (20% of revenue)** – The Consumer Media segment includes RealPlayer software which provides consumers with the ability to download and manage media on their PC, as well as mobile devices. RealPlayer is a freemium model in which the player can be downloaded for free and then additional services are sold on a subscription, as well as a one-time basis. RealPlayer also generates revenue from the sale of third-party software, such as antivirus, that is offered and sold while the RealPlayer is being downloaded. This segment also derives revenue from licensing fees for the newly introduced RealMedia high Definition (RMHD) codec that is embedded in chipsets for high definition video playback on phones, laptops, smart TV's etc.

**Mobile Services (60% of revenue)** – Revenue from this segment is primarily derived from mobile and online service providers. The Company offers Software-as-a-service (SaaS) that enables providers to offer over-the-top services such as RealTimes, which automatically creates and allows users to share video montages of photos and videos. RNWK's technology also enables carriers to offer audio & video ringback tones, and intercarrier messaging to more than 700 million mobile handsets worldwide. Services also include a music-on-demand service, which is provided in Korea. RNWK manages these services on behalf of the service provider and generally shares the revenue with the service provider.

**Games (20% of revenue)** – Revenue from this segment comes from the sale of casual electronic games, which are offered through app stores, the Company's websites, gamehouse.com and zylom.com, as well as through social networks and other third-party portals. Revenue is generated from the sale of game licenses and from advertising that is shown to consumers during online play.

## RealNetworks, Inc. (Nasdaq: RNWK)

Investment Data (as of 9/29/17)

<b>Recent Price</b>	<b>\$4.78</b>
52-Week Range	\$3.90 - \$5.45
Fiscal Year End	Dec
Dividend	N/A
Yield	N/A
Shares Outstanding	37.2 M
Average Trading Volume (3 mos)	30,000
Market Capitalization	\$180 M
Cash	\$62 M
Long-term Debt	-
Enterprise Value (EV)	\$118 M
TTM Revenue	\$126 M
EV/ Revenue	0.9x
FY17 EPS (consensus est.)	N/A
P/E	N/A
TTM EBITDA	(\$5 M)
EV/EBITDA	N/A
Book Value Per Share	\$2.17

RealNetworks also owns a 42% stake in music streaming service provider, Rhapsody. Last year Rhapsody was re-branded as Napster, which Rhapsody acquired in 2011. Rhapsody offers unlimited access to a catalog of tens of millions of music tracks. According to Midia, the Rhapsody had 4.5 million paying subscribers at the end of 2016. Rhapsody financial results are not consolidated in RealNetworks' P&L and it is recorded on the balance sheet with zero value.

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## KEY INVESTMENT CONSIDERATIONS:

### The Founder is Back and Financially Aligned

After 2 ½ years and two failed attempts at succession, Founder, Rob Glaser, was asked to return as interim CEO in 2012 and permanent CEO in 2014. Glaser owns 36% of the Company. Since taking back the leadership role, the Company's revenue base has stabilized, losses have been substantially reduced, and the company has invested in several new areas that can provide sustainable growth over the next several years.

### Pioneer video and music Streaming

- **Founded the first online media player** – After leaving Microsoft, Mr. Glaser founded RealNetworks, which became the dominant multi-media player on PCs in the mid 90's
- **Built one of the first music subscription services** – While at RealNetworks, Glaser acquired Listen.com and used it to launch Rhapsody, one of the early music subscription services.

### A Next Generation Video Codec

Real Networks is launching a next generation video codec named RMHD, which claims to outperform other standard codes, such as H.264 in terms of quality, storage, power consumption and download speeds. The adoption cycle for any new video codec is long and will require building out an entire ecosystem, which includes consumers, service providers and device manufactures.

- **Focus on China** – While the H.264 codec became the defacto video standard for much of the Internet; in China, RealPlayer's legacy video codec, RMVB, maintained a large (30%) share of the market. Based on this strength, the Company is focused on introducing its next generation video codec in China first and then expanding into the rest of the world.
- **Consumers** – In just 6 months, consumers have used RealPlayer to convert more than 3 million files into the RMHD format.
- **Device Manufacturers** – The RMHD codec is now shipping in Huawei's Mate 9 and P10 mobile phones which are very popular in China.
- **Service Providers** – Last month, RealNetworks announced a partnership with CIBN Oriental to use the RMHD codec on its network. Similar to a service like Netflix, CIBN is one of seven networks in China that is able to distribute media over the internet, instead of through a cable provider. The codec will be implemented during the fourth quarter of this year.

### Reducing Costs

	2014	2015	2016	Run Rate 2017	Δ from 2016
R&D	53	44	30	30	-
S&M	67	48	32	25	-20%
G&A	34	25	27	21	-23%
<b>Operating Expenses</b>	<b>160</b>	<b>124</b>	<b>93</b>	<b>76</b>	
<b>Decrease</b>		<b>-22%</b>	<b>-25%</b>	<b>-18%</b>	

As the table above shows that since Mr. Glaser took back the role of CEO, the Company has lowered operating costs by approximately 20% annually. This has come from a series of restructuring initiatives, reduction in work force, operating efficiencies, as well as the sale of a non-strategic portion of the company's game business. Based on management's recent comments, it appears the bulk of cost savings have been achieved and the pace of decline is likely to slow in 2018. During the 2Q17 earnings call, management said, "We believe our cost structure is more in line with our scale, and we will maintain our focus on reallocating and realigning our resources towards our growth initiatives."

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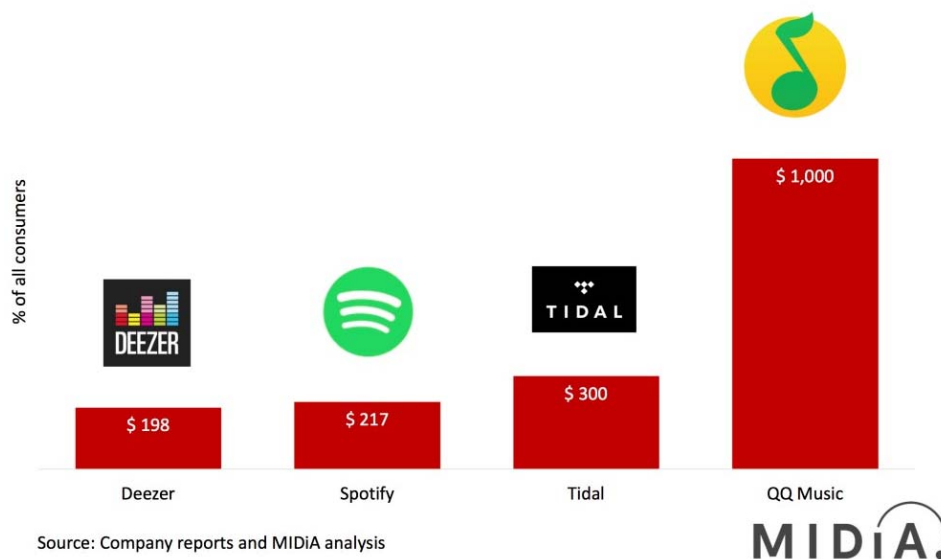
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## Valuation

### Sum of the Parts is Greater than the Whole

**Is RNWK's 42% stake in Rhapsody/Napster Worth \$10 per share?** - RealNetworks owns a 42% stake in the steaming music service, Rhapsody, which is also known under the brand Napster. The investment is held at zero on the balance sheet.

- **Rhapsody is likely up for sale** - This Spring, Rhapsody/Napster retained the investment bank Rothschild to "to review strategic options for the future," which are likely to include a sale and/or combination with another company. Around the same time, Rhapsody/Napster announced layoffs and that the CEO left the company. This occurred following the failed launch of a new product with a different business model than Rhapsody's subscription service.
- **Comparable valuation is all over the place** - To use comparable valuations to determine Rhapsody's value is difficult, as the valuations in the music streaming service providers have been all over the place in the last several years. Deezer pulled its IPO in late 2015, which valued the company over \$1 billion (\$175 per sub). Discussions for Spotify to acquire SoundCloud at a \$1 billion+ valuation also fell through late last year and it appears the valuation has dropped significantly since then. According to Re/Code, early this year, SoundCloud was entertaining offers above \$250 million. More recently, Spotify was assigned a \$13 billion valuation (\$217 per sub) and is scheduled to come public through a direct listing on the NYSE later this year. Chinese music steaming provider QQ Music, which is looking to tap the 717 million smartphone owners in China was valued at \$10 billion, or \$1,000 per subscriber.
- **Based on comparable valuations, RNWK's stake in Rhapsody is worth \$10 per share** - As shown in the table below, comparable music services are being valued at \$200+ per subscriber. Placing a \$200 per subscriber value on Rhapsody/Napster's 4.5 million subscribers would give it a value of \$900 million. At that valuation, RealNetworks' ownership stake is worth \$378 million, or \$10.22 per share.
- **It doesn't need to be worth \$10 per share to be a win for RNWK shareholders** - With RNWK's current stock price of \$4.83, it appears the market is placing zero value on its stake in Rhapsody. If Rhapsody were to sell for a fraction of the price of the comparable valuations, it would still add significant upside for RNWK shareholders. At 1/10<sup>th</sup> that of comparable valuations, Rhapsody's sale would equate to 20% upside for RNWK shareholders.



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	2016	2017	Growth Rate	2018	2019	2020
<b>Revenue</b>						
Consumer Media	25	25	15%	29	33	38
Mobile Services	70	75	10%	82.5	91	100
Games	25	25	10%	27.5	30	33
Total Revenue	120	125		138.75	154	171
<b>Gross Margin</b>						
Consumer Media	72%	80%		75%	75%	75%
Mobile Services	29%	29%		30%	32%	35%
Games	68%	68%		68%	69%	70%
Total Gross Profit	55	59		65	75	87
Total Gross Margin	46%	47%		47%	48%	51%
Operation Expenses	93	75	2.5%	70	72	74
Operating Income	-37	-16		-5	3	13
Share of Rhapsody (loss) earnings	1.7	-2				
Taxes	1.1	2		2	2	2
Net Income	-37	-20		-7	1	11
Fully Diluted Shares	36.8	36.8		36.8	36.8	36.8
<b>EPS</b>	<b>-0.99</b>	<b>-0.55</b>		<b>-0.19</b>	<b>0.03</b>	<b>0.30</b>

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 2017 will increase approximately 5%, which is consistent with growth already posted through the first six months of the year. Over the next three years our model shows an 11% annual growth rate, reaching approximately \$170 million in sales by 2020. Because the company has not given specific guidance and the timing of growth initiatives are difficult to determine, we don't expect a linear growth progression. Nevertheless, to make things simple, we use average growth rates to calculate growth over the next three years.
- **Gross margin** – We expect gross margin will expand by 5 percentage points over the next three years driven by efficiencies and a mix shift that will include a greater portion of licensing revenue.
- **Operating expenses** – Our model shows \$5 million in incremental savings during 2018, and then growth of 2.5% per year thereafter.

Our model produces \$0.30 of EPS in 2020, reflecting double-digit top-line growth, significant operating leverage and improved operating efficiencies. Applying a 25x multiple yields a valuation of \$7.50 per share, more than 50% upside from the recent price. Adding the \$1.70 per share cash, plus the potential valuation of up to \$10 per share for Rhapsody, yields a value that is nearly 4x the current stock price. Even if Rhapsody falls significantly short of the comparable valuation, it appears the current price of the stock represents an attractive risk/ reward.

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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	\$14.30	70.4%	35.3%	35.2%
New Gold (NYSE: NGD).	31-Oct-15	\$2.47	\$3.77	52.6%	28.1%	24.5%
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$9.76	-14.6%	24.3%	-38.9%
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$9.15	-21.9%	31.1%	-53.0%
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$85.49	37.5%	43.8%	-6.3%
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	44.0%	4.6%
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$4.15	150.0%	33.6%	116.4%
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$10.07	57.6%	31.7%	25.9%
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$2.82	76.3%	29.4%	46.8%
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$29.29	266.6%	29.2%	237.3%
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$21.65	51.6%	22.0%	29.6%
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$17.75	59.6%	20.1%	39.5%
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$31.17	38.5%	18.9%	19.5%
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$19.29	46.6%	25.0%	21.6%
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$8.40	15.9%	12.6%	3.3%
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$3.15	-79.3%	9.7%	-89.0%
RadNet, Inc. (Nasdaq: RDNT)	31-Jan-17	\$5.80	\$11.65	100.9%	9.3%	91.5%
Guidance Software, Inc. (Nasdaq: GUID)	28-Feb-17	\$6.60	\$7.10	7.6%	7.4%	0.2%
Calgon Carbon Corporation (NYSE: CCC)	31-Mar-17	\$14.25	\$21.35	49.8%	7.4%	42.4%
LRAD Corporation (Nasdaq: LRAD)	30-Apr-17	\$1.51	\$2.18	44.4%	6.3%	38.1%
Trecora Resources (NYSE: TREC)	31-May-17	\$10.65	\$13.00	22.1%	8.7%	13.4%
EVINE Live Inc. (Nasdaq: EVLV)	30-Jun-17	\$1.00	\$1.03	3.0%	5.2%	-2.2%
LSI Industries Inc. (Nasdaq: LYTS)	31-Jul-17	\$8.38	\$6.61	-21.1%	4.5%	-25.6%
Cooper Tire & Rubber Company (NYSE: CTB)	31-Aug-17	\$33.80	\$37.65	11.4%	5.9%	5.4%
				<b>Average</b>	<b>44.7%</b>	<b>20.6%</b>
						<b>24.2%</b>

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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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