

Mossberg's Investor Digest

From the Editor...

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

Headquartered in Santa Clara, CA, **Avaya Holdings Corp. (NYSE:AVYA)** is an iconic technology company with roots that stem back 100 years with the original U.S. "Phone Company" (AT&T). In 2000, it was spun out as a pure play in enterprise telephony and was taken private in 2007. In 2009, the company bought Nortel's enterprise equipment (Canada's Phone Company) out of bankruptcy. Burdened with an over-levered balance sheet, excessive pension liabilities, and a decade of declining sales, Avaya entered into bankruptcy itself in 2016. In December of 2017, the Company emerged from bankruptcy, with \$1 billion less in pension liabilities, a strong balance sheet, and new management with plans to restore growth.

Today, Avaya is the leading pure play provider of contact center (#1 position) and unified communications (#2 position) solutions for the largest corporations and government agencies around the world. The Company has a global presence with more than 130,000 customers and the largest installed base with a combined 144 million UC lines/CC Seats. The Company has a massive patent portfolio of more than 4,800 patents.

Importantly, during the time Avaya was a private, it underwent significant change. The company transitioned from what was primarily a hardware business, to what is primarily a software and services company. Today, 78% of revenue is derived from software and services and approximately 60% of revenue is recurring.

While reporting two positive quarters since emerging from chapter 11 is definitely a step in the right direction, it appears investors are not yet willing to give Avaya credit for what appears to be the early stages of a turn around and a positive outlook for growth. Currently the valuation is just 6.6x EV/ EBITDA, which seems like a bargain for the leader in the space poised for significant improvement in financial performance. As awareness increases and the Company continues to perform, I expect there could be significant multiple expansion.

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Issue #119

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...

Northern Technologies International Corp. (Nasdaq: NTIC)- is in the business of converting unique environmentally beneficial materials into value added products and services for industrial and consumer applications. In addition to its market leading Zerust® corrosion inhibiting packaging business, NTIC is currently leveraging its scientific expertise and established global distribution network to commercialize: Natur-Tec® bio-degradable and/or bio-based plastics for industrial and consumer applications and Zerust® corrosion solutions for oil, gas and chemical processing applications. NTIC is a global provider of corrosion inhibiting products and corrosion control management services.

BioSyent Inc. (OTC: BIOYF)- Listed on the TSXV as well (TSXV: RX), BioSyent is a profitable growth oriented specialty pharmaceutical company focused on in-licensing or acquiring innovative pharmaceutical products that have been successfully developed, are proven safe and effective, and have track records of improving the lives of patients. BioSyent supports the healthcare professionals that treat these patients by marketing its products through its community, hospital, and international business units.

Lawson Products, Inc. (Nasdaq: LAWS)- is an industrial distributor of maintenance and repair supplies, committed to helping customers improve their operating performance. A comprehensive line of products, nearly 50,000 of which are maintained in inventory Shipping to customers in all 50 states, Puerto Rico, Canada, Mexico and the Caribbean. 2016 sales of \$276.5 million, sells and distributes specialty products to the industrial, commercial, institutional and government maintenance, repair and operations market (MRO) through Lawson Products.

Methode Electronics, Inc. (NYSE: MEI)- is a global developer of custom engineered and application specific products and solutions with manufacturing, design and testing facilities all over the world. They design, manufacture and market devices employing electrical, electronic, wireless, safety radio remote control, sensing and optical technologies to control and convey signals through sensors, interconnections and controls.

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Best Idea Profile:

Avaya Holdings Corp. (NYSE:AVYA)

DESCRIPTION:

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Avaya Holdings Corp. (NYSE:AVYA)

Investment Data (as of 5/30/18)

Recent Price	\$21.57
52-Week Range	\$15.62 - \$23.76
Fiscal Year End	September
Dividend	N/A
Yield	N/A
Shares Outstanding*	110 M
Average Trading Volume (3 mos)	1.2 M
Market Capitalization	\$2.3 B
Cash & Equivalents	\$311 M
LT Debt	\$2.9B
Enterprise Value (EV)	\$5.0 B
2018 Revenue Guidance	\$3.1 B
EV/ Revenue	1.6x
2018 EBITDA Guidance	\$730-780 M
EV/ EBITDA	6.6x
Book Value/Share	\$17.00

positive outlook for growth. Currently the valuation is just 6.6x EV/ EBITDA, which seems like a bargain for the leader in the space poised for significant improvement in financial performance. As awareness increases and the Company continues to perform, I expect there could be significant multiple expansion.

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KEY INVESTMENT CONSIDERATIONS:

Management Team

Strong Operational Leadership – Jim Chirico has been with the company for 10 years, but only took over as CEO last October. He has a long and distinguished career and is known as a solid operator with an 18-year career at IBM. As EVP of Global Operations, Development and Manufacturing at Seagate, he also played a big role in what was a successful turnaround at that company. He has used his strong operational background to lead significant improvements in operations at the company over the last several years. Here are a few of the productivity improvements from 2011 to 2017:

- Service automation (quoting/pricing renewals) has increased from 11% to 96%
- Revenue per employee has increased from \$302,000 to \$376,000
- EBITDA per employee has increased from \$46,000 to \$99,000.

Along with operational metrics, financial metrics have expanded in line with an 8 and 11 percentage point improvements in product and service gross margins, respectively.

New Sales Leadership – The company just announced Dino Di Palma as President of Strategic Partners and Global Accounts. Mr. Di Palma was the former head of sales at Broadsoft and the architect for the growth that Broadsoft had over the past few years. In addition, Avaya recently hired Ron Griggs, who will lead Avaya's efforts to partner with systems integrators worldwide. Greggs is a seasoned veteran who was formerly with Deloitte and spent 20 years at Accenture.

Attracting leadership talent to return – Since taking over the CEO role, Mr. Chirico has instilled a culture of empowerment, trust and accountability that enables senior executives to take ownership of their individual business units. Several executives had left previously due to frustration over this issue. Among others, Chris McGugan returned as Chief Technology Strategist. Nikos Nikolopoulos returned as SVP of Strategy and Corporate Development. Also, Ed Nalbandian, who founded the managed services business at Avaya, returned to head up the unit.

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KEY INVESTMENT CONSIDERATIONS:

Stabilizing Revenues and positioning for Growth

As a private, Avaya has seen a 6% to 8% annual rate of decline for the past decade. And prior to going private, the Company historically was known for posting inconsistent financial results. Key to making Avaya an attractive investment and for the valuation multiple to expand are to stabilize and returning the company to a growth trajectory.

Revenue Stability – Guidance reflects revenue stability for 2018 and growth for 2019.

- **2018 Guidance - \$3.0 to \$3.1 billion.** Achieving this guidance would be the first time in 10 years the company has seen stable annual revenue trends.
- **2019 Outlook** – The Company has not given specific guidance for 2019, other than to say they expect growth.

Focus R&D on new product development – Nine months ago and CEO and CTO made a significant overhaul in R&D spending and created a new product roadmap. Historically 90% of spending was on legacy products, and that emphasis has shifted heavily to new product development. R&D efforts have led to a new mobility solution, the company is now a mobile network operator, a new cloud solution and new endpoints have been introduced. As a result, the company launched 70 new products during 2017 and was issued 78 new patents in 2018. Last quarter new produce revenue is up 30% sequentially and 60% year over year.

Well positioned with the largest customers in growth markets – Avaya has the largest installed base of lines around the world, 144 million lines in total. It has 130,000 customers, 90% of the Fortune 100 customers, government agencies in 40 countries and 6,300 channel partners. According to Gartner, each one of the segments that Avaya plays in is expected to grow double digits through 2022 as this large installed base upgrades to take advantage of the latest communications technologies.

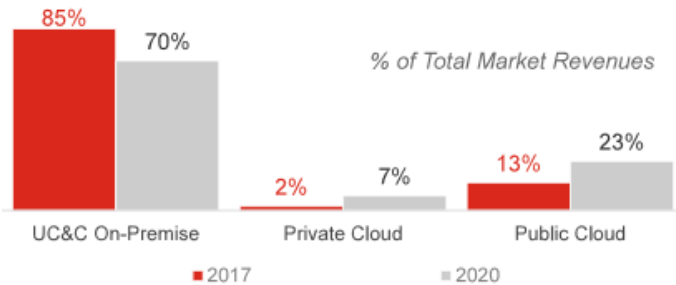
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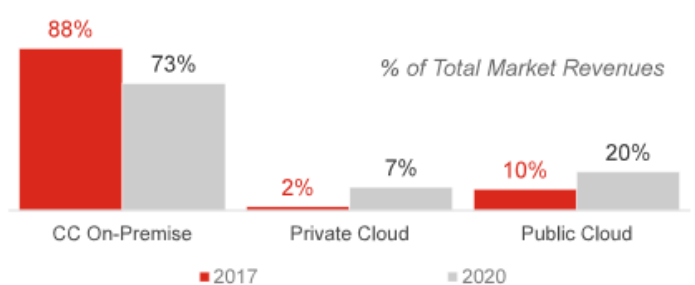
Cloud offering – There is time to catch up – Avaya has been behind the curve when it comes to introducing a cloud offering. To catch up, in March the Company acquired Spoken Communications, which had previously been a long-time partner of Avaya. The Company has already signed two large deals and “well over two dozen more deals are in the pipeline”. The total value of the pipeline is well over \$100 million. Importantly, while Avaya has been late to the party with a cloud offering, the transition has been more of an evolution than a revolution and only a small portion of the installed base of customers have switched from premises equipment to a cloud offering. This is especially true with the largest customers.

Avaya now has a cloud offer in the SMB Market – The Company has launched a cloud offering in the small-to-medium business market, an area where others have clearly gained early traction. The company expects to make money in this space and believes they have a competitive advantage in that they make their own endpoints (handset). Competitors outsource endpoints, which puts them at a disadvantage from a cost perspective.

UC&C Shift to Cloud 2017-2020



CC Shift to Cloud 2017-2020



2017-2020 UC&C Shift	Private Cloud	Public Cloud
Enterprise 1000+ Seats	3% - 5%	4% - 10%
Mid-Market 100-1000 Seats	3% - 10%	3% - 12%
SMB <100 Seats	1% - 4%	24% - 45%

2017-2020 CC Shift	Private Cloud	Public Cloud
Enterprise 1000+ Seats	3% - 9%	2% - 7%
Mid-Market 100-1000 Seats	2% - 7%	7% - 20%
SMB <100 Seats	1% - 3%	21% - 40%

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Valuation

	2017	2018	2019	2020
Revenue	3,100	3,100	3,193	3,289
Revenue Growth		-	3%	3%
Adjusted EBITDA Margin	27%	24%	25%	25%
Adjusted EBITDA	822	755	794	834
Interest Expense		175	164	152
D&A	326	350	350	350
Capex	58	68	83	98
Free Cash Flow	257	162	196	233
Cash		311	311	311
Debt		2900	2,738	2,542
Enterprise Value				6,671
EV/EBITDA Multiple				8
Market Cap				4,440
Shares Outstanding	110	111	112	113
			Price Per Share	39.18

Our back of the envelop model above makes the following assumptions:

Revenue: We assume stable revenue comparisons in 2018 and modest growth of 2019, which is consistent with management's expectations.

Adjusted EBITDA: For 2018, we use Adjusted EBITDA of \$755 million, which is at the mid-point of management's guidance. Thereafter, we assume a modest 50 basis point margin improvement for each year for the next two years. This should be very achievable given the continued mix shift to higher margin software and services revenue.

Interest: To keep things simple, we assume an 6% interest rate on the outstanding debt balance.

Valuation: We use an 8x EV/EBITDA to value the company at an enterprise value of \$6.7 billion by 2020. Working backwards from the cash and debt balance, we derive a stock value of nearly \$40 per share by the end of 2020. We believe our multiple assumption is conservative and expect the Avaya could command a higher multiple as investor awareness of the company increases and the Company proves its ability to resume growth and post consistent financial performance.

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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. Date	Relative Perf. vs. Russell 2000	
Calloway Golf Company (NYSE: ELY).	30-Sep-15	\$8.39	\$19.15	128.2%	49.7%	78.5%	
New Gold (NYSE: NGD).	31-Oct-15	\$2.47	\$2.36	-4.5%	41.8%	-46.3%	
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$6.31	-44.8%	37.5%	-82.3%	
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$8.40	-28.3%	45.1%	-73.4%	
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$95.00	52.8%	59.2%	-6.4%	
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	59.4%	-10.8%	
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$3.43	106.6%	47.9%	58.7%	
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$13.80	116.0%	45.7%	70.2%	
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$3.31	106.9%	43.2%	63.6%	
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$25.15	214.8%	43.1%	171.7%	
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$34.33	140.4%	35.1%	105.3%	
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$9.70	-12.8%	32.9%	-45.7%	
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$32.50	44.4%	31.7%	12.7%	
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$21.34	62.2%	38.3%	23.8%	
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$11.00	51.7%	24.6%	27.1%	
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$2.35	-84.6%	21.4%	-106.0%	
RadNet, Inc. (Nasdaq: RDNT)	31-Jan-17	\$5.80	\$12.85	121.6%	21.0%	100.5%	
Guidance Software, Inc. (Nasdaq: GUID)	28-Feb-17	\$6.60	\$7.10	7.6%	18.8%	-11.3%	
Calgon Carbon Corporation (NYSE: CCC)	31-Mar-17	\$14.25	\$21.50	50.9%	18.9%	32.0%	
LRAD Corporation (Nasdaq: LRAD)	30-Apr-17	\$1.51	\$2.18	44.4%	17.7%	26.7%	
Trecora Resources (NYSE: TREC)	31-May-17	\$10.65	\$14.05	31.9%	20.3%	11.7%	
EVINE Live Inc. (Nasdaq: EVLV)	30-Jun-17	\$1.00	\$1.11	11.0%	16.4%	-5.4%	
LSI Industries Inc. (Nasdaq: LYTS)	31-Jul-17	\$8.38	\$5.55	-33.8%	15.6%	-49.4%	
Cooper Tire & Rubber Company (NYSE: CTB)	31-Aug-17	\$33.80	\$25.85	-23.5%	17.3%	-40.8%	
RealNetworks, Inc. (Nasdaq: RNWK)	30-Sep-17	\$4.78	\$3.61	-24.5%	10.5%	-35.0%	
NCI Building Systems, Inc. (NYSE: NCS)	30-Oct-17	\$15.65	\$19.40	24.0%	10.5%	13.4%	
TransAct Technologies, Inc. (Nasdaq: TACT)	30-Nov-17	\$13.60	\$10.75	-21.0%	6.7%	-27.7%	
Regis Corporation (NYSE: RGS)	30-Dec-17	\$15.36	\$17.37	13.1%	7.3%	5.8%	
Team, Inc. (NYSE: TISI)	30-Jan-18	\$16.95	\$21.25	25.4%	4.1%	21.3%	
Andina Acquisition Corp II (Nasdaq:ANDA)	28-Feb-18	\$9.85	\$9.25	-6.1%	9.0%	-15.1%	
GSE Systems, Inc. (NYSE:GVP)	31-Mar-18	\$3.25	\$3.15	-3.1%	7.8%	-10.8%	
Telaria, Inc. (NYSE:TLRA)	30-Apr-18	\$4.13	\$4.01	-2.9%	6.9%	-9.8%	
				Average	34.8%	27.1%	7.7%

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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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