

# Mossberg's Investor Digest

## From the Editor...

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

ERP consulting company, **Edgewater Technology (Nasdaq:EDGW)**, is in the process of merging with privately held Alithya. Edgewater will essentially be absorbed into Alithya. The combined company will keep the Alithya name and trade on the Nasdaq and Toronto Stock exchanges. The transaction is expected to be completed during the third quarter of 2018.

The merger is the result of a strategic alternative review conducted by Edgewater since activist investors won a proxy battle in 2017. Activist investors replaced four of the EDGW's eight board seats and ultimately the senior management team was replaced.

The combined company will be a leading technology consulting company in North America with more than 2,000 professionals. The combined company will offer consulting services that help customer implement and improve ERP, CRM, and BI technologies offered primarily by Microsoft and Oracle. In addition, the companies offer a full suite of other services.

Effectively, investors buying stock in Edgewater today are buying New Alithya (the combined company) stock at \$2.89 per share (converted price less the converted dividend amount). Based on this cost basis and the our "back-of-the-envelope" valuation, we believe shareholders could see upside of more than 40% per year for the next three years.

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## July 2018

Issue #121

Every month we hear ideas suggested from our large network of professional investors. Here are a few of the ideas we heard this month.

**Sturm, Ruger & Company, Inc. (NYSE: RGR)**- Is one of the nation's leading manufacturers of rugged, reliable firearms for the commercial sporting market. As a full-line manufacturer of American-made firearms, Ruger offers consumers over 400 variations of more than 40 product lines, all prove that Ruger has a rugged, reliable firearm to meet every shooter's needs. For more than 60 years, Ruger has been a model of corporate and community responsibility. Their motto, "Arms Makers for Responsible Citizens®," echoes their commitment to these principles as they work hard to deliver quality and innovative firearms.

**Green Brick Partners, Inc. (Nasdaq: GRBK)** - Invests in a wide range of real estate investments. The Company acquires and develops land, provides land and construction financing to its controlled builders, and participates in the profits of its controlled builders. They provide expertise and capital to build neighborhoods and in turn provide a superior long-term return for investors, residents, and cities they build in. GRBK has superior financial and operating metrics despite having one of the lowest debt to capital ratios among public builders. As part of their disciplined investment approach they intend to pursue the acquisition of additional homebuilders in their core or new markets and to pursue a robust pipeline of development opportunities to fuel future expansion.

**MSG Networks Inc. (NYSE: MSGN)** - An industry leader in sports production, and content development and distribution, MSG Networks Inc. owns and operates two award-winning regional sports and entertainment networks, MSG Network (MSG) and MSG+, and a live streaming and video on demand platform, MSG GO. The networks are home to 10 professional sports teams, delivering live games of the New York Knicks; New York Rangers; New York Islanders; New Jersey Devils; Buffalo Sabres; New York Liberty; New York Red Bulls and the Westchester Knicks, as well as coverage of the New York Giants and Buffalo Bills. The gold standard for regional broadcasting, MSG Networks has won 152 New York Emmy Awards over the past ten years.

**Verint Systems Inc. (Nasdaq: VRNT)**- Is a global leader in Actionable Intelligence solutions that empower organizations with services help organizations of all sizes and across many industries make more informed, timely, and effective decisions.

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Best Idea Profile:

Alithya/Edgewater (NYSE:EDGW)

## DESCRIPTION:

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Edgewater's primary domain expertise is in the manufacturing vertical, which will complement Alithya's expertise in financial services, telecom, energy, transportation, health care and government services sectors.

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### Alithya/Edgewater (NYSE:EDGW)

Investment Data (as of 7/31/18)

<b>Recent Price</b>	<b>\$5.20</b>
52-Week Range	\$4.25 - \$7.30
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding*	45.3 M
Average Trading Volume (3 mos)	18,000
Market Capitalization*	\$180 M
Cash	-
Net Debt*	\$37 M
Enterprise Value (EV)	\$215 M
2017 Revenue*	\$260 M
EV/ Revenue	0.8x
2017 EBITDA*	\$15.7 M
EV/ EBITDA	13.6x

\*proforma – post merger

EDGW Shares Outstanding	14.5M
Conversation to Alithya Shares	1.3118
New Alithya Shares owned by EDGW shareholders (42% post-merger)	19.0M
<b>Total Outstanding Shares</b>	<b>45.3</b>
Current Price	5.20
Conversation Ratio	1.3118
<b>Combined company price</b>	<b>3.96</b>
<b>Market Capitalization</b>	<b>180</b>

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## KEY INVESTMENT CONSIDERATIONS:

### Deal Terms

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**Edgewater Shareholders will own 42% of the combined company** - The deal was essentially structured so that both sides can see upside in the transaction. Edgewater shareholders will receive \$1.41 per share in cash in the form of a special dividend and 1.311 shares of New Alithya stock. The conversion is subject to minor changes based on EDGW's performance prior to closing.

**The board will be 2/3 Alithya** – Six of New Alithya's nine board members will be nominated by Alithya's current board and three by Edgewater's current board. Pierre Turcotte will remain Chairman of the combined company.

**Large shareholders, directors and officers of both companies have agreed to a lock up** – Management and several of Edgewater's largest shareholders, representing 26% stake in Edgewater and several of Alithya's large shareholders representing a 79% stake have agreed to lock up agreements post-merger.

### Deal Logic

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**Cost synergies** – The Company has identified \$5 million of cost synergies including combining corporate overhead and optimizing the combined companies' operations. Two thirds of the cost synergies are expected to be realized with in the first six months and 100% within the first year.

**Revenue Synergies** – There are Significant cross selling opportunities for the combined businesses.

- **Microsoft** - Edgewater has a very developed Microsoft ERP consulting practice in the U.S. Alithya has a Microsoft practice in Canada, but it is less developed. Using expertise from Edgewater, management believes there is significant growth opportunities to grow the Microsoft business in Canada. Likewise, Alithya has a significant consulting expertise with Microsoft in business intelligence and machine learning that management believes it can leverage with Edgewater's customer base in the U.S.
- **Oracle** – Alithya has built a significant expertise in Oracle ERP consulting, including cloud-based solutions that management believes it can sell into Edgewater's U.S. clients.

**Critical mass for capital markets** – Edgewater's market cap over the past five years has averaged about \$100 million, which made it difficult to attract broad-based investor attention and its smaller size was likely a reason for the significant discount in its valuation multiple relative to larger peers. Based on the current price of EDGW shares, the combined company's market capitalization would be \$178 million, which is just over the lower end of the range to be included into the Russell 2000 index. The smallest market cap to be included during the 2018 rebalancing was \$161 million. If the combined company can sustain or grow this valuation, not only is it likely to be included in a significant amount of passive index funds and ETFs, it is also more likely to make it on the radar screens of fundamental investors that require minimum market caps and liquidity before considering an investment.

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## KEY INVESTMENT CONSIDERATIONS:

### A Strong Jockey

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**CEO Paul Raymond is successfully executing a proven “buy and build” strategy** - The current CEO of Alithya, Paul Raymond, will be the CEO of the combined company. Mr. Raymond has more than 30 years of experience including 17 years' experience and CGI, the \$10 billion IT Canadian Services company, where among other responsibilities, he oversaw integration of acquisitions, important experience to have to execute Alithya's growth plan. CGI was largely built based on a successful “buy and build” strategy. It appears that Mr. Raymond is duplicating that strategy with Alithya. Under his leadership the company has grown 550% since 2012 through a combination of organic and acquisitive growth.

### Alithya's impressive growth formula

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From its founding until 2011, when current CEO, Paul Raymond took the helm, Alithya grew from 10 to 200 consultants. Since that time, through a combination of five acquisitions and internal growth, Alithya has growth to more than 1,600 professionals.

**“Be a disruptive market consolidator in a very fragmented industry”** - This plan was based on input from customers who said they were looking for an alternative in the market. There are M&A opportunities that will add presence in key markets as well as geographies. M&A activities in this space offer not only cost, but also revenue synergies.

**Buy-and-Build** – In addition to the revenue from acquired companies, Alithya has been able to drive impressive organic growth. The key to Alithya's strategy is to take the specialized offering of acquired companies and sell it to larger accounts and a much larger distribution network. They have been successful at acquiring smaller companies that have had limited distribution and expanding their businesses. For example, Alithya has doubled Pro2p business since acquiring it in November of 2016 and grew SWI's business by 17%, a business it acquired last year.

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## Valuation

	2017	FY19	FY20	FY21	FY22
Revenue	260	260	298	343	395
Revenue Growth			15%	15%	15%
EBITDA Margin	6.0%	6.5%	8.0%	9.0%	10.0%
<b>EBITDA</b>	<b>15.7</b>	<b>16.8</b>	<b>23.9</b>	<b>30.9</b>	<b>39.5</b>
Debt	37	37	25	10	
Cash	0	0	0	0	10
EV/EBITDA multiple			9	9	9
Enterprise Value			215	278	355
Market Cap			190	268	365
Shares outstanding	45.3	46.2	47.1	48.1	49.0
<b>Share Price</b>			<b>\$4.03</b>	<b>\$5.58</b>	<b>\$7.45</b>

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

**Revenue:** For FY19 (Ending March 2019), we assume \$260 million of revenue, which is consistent with management guidance. Beginning in Fiscal 2020, we assume 15% revenue growth for the next three years. Management articulated a target to double revenues during the next three to five years, which is the equivalent of 15% to 25% growth. We conservatively assume five years, which yields a 15% top-line growth rate. Supporting this growth rate assumption is Alythia's 2017 organic revenue growth of 20%.

**EBITDA Margin:** For FY19, we use an EBITDA margin of 6.5%, which is consistent with the low end of management's guidance. We expect a 150-basis point improvement in FY20 and a one percentage point improvement for each of the next years thereafter. Ten percent EBITA margin is near the lower end of management's 3-to-5-year targeted range of 9% to 13%.

**Net Debt Levels:** We use EBITDA as a proxy for cash flow and assume that 50% of EBITDA will be used to pay down debt levels.

**Shares outstanding:** We assume that shares will increase at 2% per year, related to stock employee stock options.

**Valuation Multiple:** We use an EV/ EBITDA multiple of 9x, which represents a significant discount related to larger IT consulting companies that trade at 11x to 13x multiple. We use a more conservative multiple to reflect the Alithya's smaller size.

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	FY20	FY21	FY22
Original Edgewater Share price	\$5.15	\$5.15	\$5.15
Converted to Alithya Share price	1.3118	1.3118	1.3118
Converted share price	\$3.93	\$3.93	\$3.93
Special dividend (converted)	\$1.07	\$1.07	\$1.07
Total Investment per share	\$2.85	\$2.85	\$2.85
Share Price at 9x EV/EBITA	\$4.05	\$5.62	\$7.50
<b>Return</b>	<b>42%</b>	<b>97%</b>	<b>163%</b>

**Return calculation** – We calculate return by using our per-share “back-of-the-envelope” valuation of New Alithya shares 1 to 3 years from now, which is shown on the previous page. We then derive the cost basis by converting Edgewater share price into the equivalent New Alithya share price and then subtracting the converted special dividend from the cost basis.

- **Converted Alithya share price** - Each Edgewater shareholder will receive 1.3118 shares of Alithya stock. To derive the equivalent per share investment price, we divide the current price of Edgewater shares \$5.20, by the conversion ratio, 1.3118.
- **Converted Special Dividend** – Each shareholder will receive \$1.41 per share in cash as part of the special dividend. This is also converted into the equivalent New Alithya per share amount by dividing the special dividend by the conversion ratio of 1.3118.

Effectively, investors buying stock in Edgewater today are buying New Alithya stock at \$2.89 per share (converted price less the converted dividend amount). Based on this cost basis and the our “back-of-the-envelope” valuation, shareholders could see upside of more than 40% per year for the next three years.

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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	\$19.29	129.9%	51.1%	78.8%
New Gold (NYSE: NGD)	31-Oct-15	\$2.47	\$1.21	-51.0%	43.2%	-94.2%
Townsquare Media (NYSE: TSQ)	30-Nov-15	\$11.43	\$6.50	-43.1%	38.8%	-82.0%
Build-A-Bear Workshop (NYSE: BBW)	31-Dec-15	\$11.72	\$7.85	-33.0%	46.4%	-79.5%
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$89.92	44.6%	60.7%	-16.0%
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	60.9%	-12.3%
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$3.03	82.5%	49.3%	33.2%
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$18.25	185.6%	47.1%	138.5%
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$3.06	91.3%	44.6%	46.7%
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$25.40	217.8%	44.4%	173.4%
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$34.85	144.0%	36.3%	107.7%
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$10.75	-3.3%	34.2%	-37.5%
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$32.50	44.4%	32.9%	11.5%
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$19.45	47.8%	39.6%	8.2%
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$10.95	51.0%	25.8%	25.2%
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$1.35	-91.1%	22.6%	-113.7%
RadNet, Inc. (Nasdaq: RDNT)	31-Jan-17	\$5.80	\$13.45	131.9%	22.1%	109.8%
Guidance Software, Inc. (Nasdaq: GUID)	28-Feb-17	\$6.60	\$7.10	7.6%	20.0%	-12.4%
Calgon Carbon Corporation (NYSE: CCC)	31-Mar-17	\$14.25	\$21.50	50.9%	20.0%	30.9%
LRAD Corporation (Nasdaq: LRAD)	30-Apr-17	\$1.51	\$2.73	80.8%	18.8%	62.0%
Trecora Resources (NYSE: TREC)	31-May-17	\$10.65	\$14.75	38.5%	21.4%	17.1%
EVINE Live Inc. (Nasdaq: EVLV)	30-Jun-17	\$1.00	\$1.43	43.0%	17.5%	25.5%
LSI Industries Inc. (Nasdaq: LYTS)	31-Jul-17	\$8.38	\$4.90	-41.5%	16.7%	-58.2%
Cooper Tire & Rubber Company (NYSE: CTB)	31-Aug-17	\$33.80	\$28.10	-16.9%	18.4%	-35.2%
RealNetworks, Inc. (Nasdaq: RNWK)	30-Sep-17	\$4.78	\$3.53	-26.2%	11.6%	-37.7%
NCI Building Systems, Inc. (NYSE: NCS)	30-Oct-17	\$15.65	\$15.55	-0.6%	11.6%	-12.2%
TransAct Technologies, Inc. (Nasdaq: TACT)	30-Nov-17	\$13.60	\$11.55	-15.1%	7.7%	-22.8%
Regis Corporation (NYSE: RGS)	30-Dec-17	\$15.36	\$17.46	13.7%	8.3%	5.3%
Team, Inc. (NYSE: TISI)	30-Jan-18	\$16.95	\$22.90	35.1%	5.1%	30.0%
Andina Acquisition Corp II (Nasdaq:ANDA)	28-Feb-18	\$9.85	\$9.07	-7.9%	10.0%	-17.9%
GSE Systems, Inc. (NYSE:GVP)	31-Mar-18	\$3.25	\$2.87	-11.6%	8.8%	-20.3%
Telaria, Inc. (NYSE:TLRA)	30-Apr-18	\$4.13	\$3.67	-11.1%	7.9%	-19.0%
Avaya Holdings Corp. (NYSE:AVYA)	31-May-18	\$21.57	\$20.58	-4.6%	1.8%	-6.4%
Tenneco, Inc. (NYSE:TEN)	30-Jun-18	\$43.96	\$46.00	4.6%	1.2%	3.4%
				<b>Average</b>	<b>33.4%</b>	<b>26.7%</b>
						<b>6.8%</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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