Mossberg's Investor Digest

## From the Editor…

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

Founded in 1986 and headquartered in Santa Clara, California; **Landec Corporation (Nasdaq:LNDC)** is a conglomerate with two operating companies and an investment in a third. The two operating companies are 1) Curation Foods, a provider of fresh, plant-based foods, including packaged vegetables, olive oils, soups, and guacamole; and 2) Lifecore Biomedical, a manufacturer of hyaluronic acid used in ophthalmology and orthopedic medicine, as well as other medical-grade viscous medicines. LNDC also has a 27% interest in Windset Farms, the largest hydroponic grower in North America. The current book value of Winstead is $67MM.

The food business ($530MM in rev) will benefit from a strategy to become a branded natural foods company. Growth of new branded foods, will de-emphasize the fresh packaged vegetable business, which can see significant distortion in financial results due to variations in seasonal factors, such as the high costs of sourcing product during shortages. New internally-developed and acquired brands are in high growth areas and should produce greater margin and more predictability and consistent revenue and earnings growth.

Lifecore ($70MM in rev) has been investing alongside partners and has built-out approximately 70% new capacity to manufacture highly viscous new medicines. Not all of these new drugs will need to move into commercialization for Lifecore to enjoy 10-15% growth for the next several years.

Our sum of the parts valuation derives a current value of the company at $16.17 per share, 32% higher than the current price. Longer term, out back of the envelop calculation derives a value of $23 per share

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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.

**Qualys, Inc. (Nasdaq: QLYS)** -Qualys is a pioneer and leading provider of cloud-based security and compliance solutions with over 10,300 customers in more than 130 countries, including a majority of each of the Forbes Global 100 and Fortune 100. They help organizations streamline and consolidate their security and compliance solutions in a single platform and build security into digital transformation initiatives for greater agility, better business outcomes and substantial cost savings.

**Model N, Inc. (NYSE: MODN)-** Model N is the leading provider of Revenue Management solutions for the life sciences and technology industries. The company helps customers maximize revenues, drive growth and reduce compliance risk by transforming the revenue lifecycle from inefficient disjointed operations into a strategic end-to-end process. Model N supports the complex business needs of the world's leading brands in pharmaceutical, medical device, high tech, manufacturing and semiconductors across more than 120 countries, including Pfizer, AstraZeneca, Sanofi, Gilead, Abbott, Stryker, AMD, Micron, Seagate, STMicroelectronics, NXP, Sesotec, and Southern States.

**Quotient Technology Inc. (NYSE: QUOT)-** Quotient is the leading CPG marketing technology ecosystem that delivers data-powered, personalized, frictionless digital promotions and ads that inspire action and deliver results**.** Quotient provides digital promotions and advertising solutions driven by online and in-store data. Their industry-leading network connects millions of shoppers with CPG brands and retailers.

**Ooma, Inc. (NYSE: OOMA) -** Ooma creates new communications experiences for small businesses and consumers. Its smart SaaS platform serves as a communications hub, which offers cloud-based telephony, home security and other connected services. Business and residential communications solutions deliver its proprietary high-definition voice quality, advanced features and integration with mobile devices, at extremely competitive pricing and value. Ooma Home is a groundbreaking connected security solution including a smart video camera with facial recognition and a full range of security sensors that easily and affordably put consumers in charge of protecting their businesses and homes. Ooma is also partnering with connected device makers to create smarter offices and homes.

**Best Idea Profile:** **Landec Corporation (Nasdaq:LNDC)**

## DESCRIPTION:

Founded in 1986 and headquartered in Santa Clara, California; **Landec Corporation (Nasdaq: LNDC)** is a conglomerate with two operating companies and an investment in a third. The two operating companies are 1) Curation Foods, a provider of fresh, plant-based foods, including packaged vegetables, olive oils, soups, and guacamole; and 2) Lifecore Biomedical, a manufacturer of hyaluronic acid used in ophthalmology and orthopedic medicine, as well as other medical-grade viscous medicines. LNDC also has a 27% interest in Windset Farms, the largest hydroponic grower in North America. The current book value of Winstead is $67MM.

Both the food and medical businesses are expected to average a double-digit growth pace over the next 5 years.

The food business ($530MM in rev) will benefit from a strategy to become a branded natural foods company. Growth of new branded foods, will de-emphasize the fresh packaged vegetable business, which can see significant distortion in financial results due to variations in seasonal factors, such as the high costs of sourcing product during shortages. New internally-developed and acquired brands are in high growth areas and should produce greater margin and more predictability and consistent revenue and earnings growth.

Lifecore ($70MM in rev) has been investing alongside partners and has built-out approximately 70% new capacity to manufacture highly viscous new medicines. Not all of these new drugs will need to move into commercialization for Lifecore to enjoy 10-15% growth for the next several years.

**Landec Corporation (Nasdaq: LNDC)**
Investment Data (as of 3/31/19)

| | |
|---|---|
| **Recent Price** | **$12.28** |
| 52-Week Range | $10.17 - $15.60 |
| Fiscal Year End | May |
| Dividend | N/A |
| Yield | N/A |
| Shares Outstanding* | 29.2 M |
| Average Trading Volume (3 mos) | 92,000 |
| Market Capitalization | $358 M |
| Cash | $2 M |
| LT Debt* | $145 M |
| Enterprise Value (EV) | $501 M |
| FY19 Rev Guidance** | $560 M |
| EV/ Revenue | 0.9x |
| FY19 EPS Guidance** | $0.27 |
| P/E | 45 |
| Book Value Per Share | $9.13 |

*Includes Debt from Yucatan acquisition
** Midpoint of management Guidance

At the end of FY 2018, the company had 710 employees located in 15 locations in the United States.

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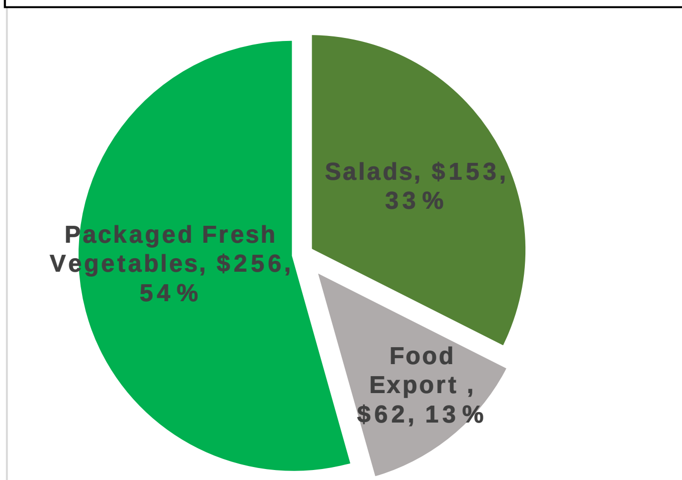
## KEY INVESTMENT CONSIDERATIONS:

### Transforming the food business –

FY17 Revenue Mix = $470 million revenue

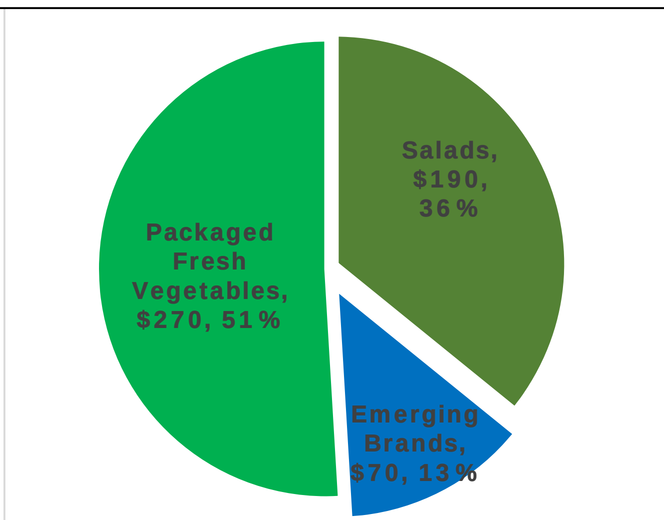
***One brand representing approximately 33% of revenue***




Branded Salad Kits

Current Revenue Mix = $530 million annual run rate

***Five brands representing approximately 50% of revenue***




Branded Salad Kits

Fresh Guacamole

Fresh Guacamole

Plant-based Soups

Olive oil & Vinegar

The Company is transforming its food business from fresh packaged vegetable business to a branded natural foods company like Amy's or Chibani. This transformation involved exiting the food export business (the grey section of the chart above) and other less profitable business lines and replacing them with branded food products that carry higher margins. Through a combination of internal development and acquisitions, during the past several years the company has gone from one brand to five, and now has an emerging branded foods business with an annualize run rate of $70 million.

## KEY INVESTMENT CONSIDERATIONS:

### Transforming the food business (cont'd)

**The success of its first brand - Eat Smart:** Landec launched its first brand, Eat Smart in 2012, which includes vegetable bags & trays, as well as single-serve and multi-serve salad kits. The Company grew this business from zero to $185 million in just 6 years, a CAGR of 28% from FY12 to FY18. At 6.4% market share in the U.S. and 39% in Canada, the company still has ample room to grow this business in North America.

**Growth of emerging natural fresh foods brands:** The company has recently rebranded its food business as Curation Foods and has built a portfolio of premium natural fresh food brands. The Curation portfolio of brands includes the following characteristics

- Premium positioning
- Plant-based foods made form 100% clean ingredients, (no un-natural preservatives)
- High growth segments
- High margin businesses
- Much less volatility in the supply chain – ingredients are less susceptible to shortages that can cause significant changes in availability and/or costs.

- **April 2017** - Acquired O Olive Oil & Vinegar company – Premium, California-grown olive oil and vinegars. The Company has since built in-house vinegar production capacity and did a brand refresh. As a result, distribution points increased by 200%. The brand is expected to do $7 million during FY19, up from $3 million at the acquisition date.
- **October 2018** – The company internally developed and launched a new brand called Now Planting, which is a new line of refrigerated plant-based soups. Soup is a $6 billion category and there a few new entrants into this market.
- **December 2018** – Acquired Yucatan foods for $80 million, $60 million in cash and $20 million in equity. The purchase price was valued at approximately 10x-12x EBITDA, but is expected to be 6x-8x following post acquisition synergies. With the acquisition came the brands Yucatan & Cabo Fresh, which include guacamole and avocado butter products. Yucatan has an annual revenue run rate of $60 million and a robust new product development pipeline. In addition, the acquisition offers significant cross selling opportunities.

**Changing the Margin Profile:** According to management, the company has shed approximately $120 million in low-margin business, including the export business that was discontinued at the end of FY18. The Company has more than replaced this business with higher margin business, including the rapid growth of the Eat Smart brand. Historically the food business has been a 10% to 11% gross margin business, which doesn't leave much room for innovation. With the acquisition of Yucatan, the company is striving for a 30% gross margin. At a blended rate, gross margin should be able to add five to six percentage points. This should also leave a point or two of margin to spend incrementally for developing and introducing new products, which is a key to sustainable growth.

**Improving Cost Profile:** Management believes there is significant opportunities to cut costs from its existing businesses, as well as realize savings from consolidating the operations of the Yucatan acquisition.

## KEY INVESTMENT CONSIDERATIONS:

### The food business has a significant competitive moat

**Fresh Flood Supply Chain –** Because most products have an average shelf life of 17 days, it is extremely important to be able to control and quickly move products from the farm to the supermarket. The biggest part of Landec's competitive moat is its supply chain, which includes a network of growers throughout North, Central and South America; Five refrigerated processing faculties; and a fleet of refrigerated trucks.

**Distribution -** Landec sells in 73% of all retail stores and has at least one product in every club store in North America.

**Internal Innovation** - This quality is a bit tough to measure, but with the success of the Eat Smart brand, LNDC has a proven track record of successfully introducing new fresh food products. The company also has a considerable budget for innovation. In FY2018, the company spent $5.5 million on R&D for the food business.

### Double-digit growth from the Lifecore Biomedical

Lifecore has been a significant and steady contributor to growth and earnings since it was acquired in 2010. Since that time, Lifecore has grown from $20 million to $65 million in FY18, a CAGR of 16%. This business, which currently produces EBITDA margins of 30% to 33%, is very predictable.

**Evolved the business model** – The company started as a supplier of Hyaluronic Acid, which is an extremely viscus (like Vaseline) liquid used in ophthalmology and orthopedic treatments. The process for of producing and filling containers with this viscus liquid for medical use is very difficult and took decades to develop. About three years ago, Lifecore found that other customers need this type of capability for other viscus liquids.

**New Capacity –** The company has invested $55 million over the last three years to expand production capability and develop a new, multi-purpose filling line. Although commercial revenue generated from this line will vary depending on product mix in any given year, at full capacity the new line has the potential to generate $40 million to $50 million of new product revenue annually.

## Valuation

**Sum of the Parts Valuation:** Using a sum of the parts valuation, we calculate that the current value of the company is approximately $16.17 per share, a valuation that is 32% higher than the current price. To calculate our valuation, we use the following assumptions of each company.

1) ***Winstead Farms*** **–** LNDC invested $22 million in the form of preferred stock, which yields a cash dividend of 7.5% ($1.7 million) annually. The valuation is recorded on LNDC's balance sheet for $67 million. This valuation is done using the fair value method.

2) **Lifecore Biomedical –** LNDC breaks out EBITDA for its Lifecore Biomedical business in its investor presentation. In FY18 Lifecore Biomedical produced $21 million of EBTIDA. We believe this business could command a 12-15x multiple of EBITDA, which would yield a $285 million valuation at the mid-point.

3) **Curation Foods** – We use a 0.5x revenue multiple to calculate a value of $265 million. This multiple is a discount to other branded food companies that are valued at more than 1x revenue. We used a discount to reflect that significant fluctuations in financial performance that can occur as a result of seasonal weather fluctuations. We believe this discount will be eroded, as planned cost savings are realized, and emerging brands take hold and grow as a percentage of overall revenue. Increased contribution from these lines of business will generate higher overall margins, as well as more stability in revenue and earnings trends.

| | |
|---|---|
| Sales | 530 |
| EV/ S | 0.5 |
| **Curation Food Valuation** | **$265** |
| 2018 EBIDA | 21 |
| EV/EBITDA | 13.5 |
| **Lifecore Biomedical Valuation** | **$284** |
| **Windstead Farms Valuation** | **67** |
| **Sum of the Parts** | **615.5** |
| Debt | 145 |
| Market Cap | $471 |
| Shares Outstanding | 29.1 |
| **Share Price** | **$16.17** |

## Valuation

**Back of the envelope Valuation:**

(In $ millions)

| | FY18 | FY19 | FY20 | FY21 | FY22 |
|---|---|---|---|---|---|
| Curation Foods | 455 | 485 | 528 | 555 | 582 |
| *Growth Rate* | | *7%* | *9%* | *5%* | *5%* |
| Lifecore | 65.4 | 75.2 | 84.3 | 94.4 | 105.7 |
| *Growth Rate* | | *15%* | *12%* | *12%* | *12%* |
| **Total Revenue** | **524.2** | **559.8** | **612.4** | **648.9** | **688.0** |
| *Growth Rate* | *12%* | *7%* | *9%* | *6%* | *6%* |
| **Adjusted-EBITDA** | **26.1** | **30.8** | **39.8** | **48.7** | **58.5** |
| *EBITDA Margin* | *5.0%* | *5.5%* | *6.5%* | *7.5%* | *8.5%* |
| EV/ EBITDA Multiple | | | | | 12 |
| Enterprise Value | | | | | 702 |
| CAPEX | | 42 | 42 | 25 | 25 |
| Cash | 2.9 | 0 | 0 | 0 | 0 |
| Debt | 69.3 | 150 | 150 | 126 | 93 |
| FMV of Windset Farms | 66.5 | 69.8 | 73.3 | 77.0 | 80.8 |
| Market Cap | | | | | $690 |
| Shares outstanding | 27.5 | 29.1 | 29.4 | 29.6 | 29.9 |
| **Share Price** | | | | | **$23.11** |

Our back of the envelop valuation above makes the following assumptions regarding valuation:

**Revenue:** For Fiscal 2019, we expect revenue to grow at 7%, which reflects the mid-point of management's guidance. The food business for FY19 should include about $30 million of revenue from the Yucatan acquisition and modest growth organically. We assume 15% growth for Lifecore for FY19, which is also the midpoint of management guidance. We expect FY20 revenue to benefit from the full year's contribution from Yucatan, as well as modest growth organically. We expect that our growth rate of 5% for the food business in the out years may prove to be conservative, especially as the company gains traction with its emerging brands, which are in large and fast-growing categories. We assume 12% growth for the LifeCore business, which is consistent with management's statements.

**EBITDA Margin:** We assume a 50 basis point improvement in FY19 and a one percentage point improvement per year thereafter. We believe the mix shift to higher margin products, cost cutting initiatives and earnings leverage will enable at least 350 basis points of improvement during the next three years.

**CAPEX:** We assume $42 million in CAPEX for FY19, which is consistent with management's guidance. We expect another year of accelerated spending in FY20, and assume spending will taper off thereafter.

## Valuation

### Back of the envelope Valuation: (cont'd)

**Cash Flow:** We use EBITDA as a proxy for operating cash flow. With accelerated spending over the next two years, the company will not begin to generate positive cash flow until FY21. We assume that excess cash will be used to repay debt, which will have an accelerating affect on equity appreciation.

**Share Count:** We assume a 250,000 per year of share based compensation, which is consistent with trends in recent years.

**FMV of Windset Farms:** We assume the fair market value of Windset Farms will appreciate by 5% per year through 2022, which is consistent with the recent increase in value. LNDC has a put option for its investment in Windset, which it could exercise in FY21 and receive cash payment for in FY22. We believe it is likely that management will exercise this option and have therefore included it as cash in our valuation.

**Valuation:** We assume LNDC will trade at an enterprise value of 12x EBITDA, which we believe is fair given the company's growth characteristics and potential to drive double digit returns. By applying a 12x multiple to our forecasted 2022 EBITDA of $58.5 million, we work backwards from enterprise value to come up with a value of $23 per share, nearly 90% upside from current levels.

## Mossberg's Investor Digest Idea Performance

The table below shows the relative change in the value of the ideas published since April 2016 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 |
|---|---|---|---|---|---|---|
| PAR Technology Group (NYSE: PAR) | 30-Apr-16 | $6.39 | $24.36 | 281.2% | 35.7% | 245.5% |
| Full House Resorts Inc. (Nasdaq: FLL) | 30-May-16 | $1.60 | $2.02 | 26.3% | 33.4% | -7.2% |
| Control4 Corporation (Nasdaq: CTRL) | 30-Jun-16 | $7.99 | $16.88 | 111.2% | 33.3% | 77.9% |
| KapStone Paper and Packaging Corporation (NYSE: KS) | 31-Jul-16 | $14.28 | $35.00 | 145.1% | 25.8% | 119.3% |
| Ampco-Pittsburgh Corp. (NYSE: AP) | 31-Aug-16 | $11.12 | $3.24 | -70.9% | 23.8% | -94.7% |
| Select Comfort Corporation (Nasdaq: SCSS) | 30-Sep-16 | $22.51 | $32.50 | 44.4% | 22.6% | 21.7% |
| Northwest Pipe Co. (NWPX) | 31-Oct-16 | $13.16 | $23.97 | 82.1% | 28.8% | 53.3% |
| Mitel Networks Corporation (Nasdaq: MITL) | 30-Nov-16 | $7.25 | $11.15 | 53.8% | 16.1% | 37.7% |
| Black Box Corporation (Nasdaq: BBOX) | 31-Dec-16 | $15.25 | $1.10 | -92.8% | 13.1% | -105.9% |
| RadNet, Inc. (Nasdaq: RDNT) | 31-Jan-17 | $5.80 | $12.37 | 113.3% | 12.7% | 100.6% |
| Guidance Software, Inc. (Nasdaq: GUID) | 28-Feb-17 | $6.60 | $7.10 | 7.6% | 10.7% | -3.1% |
| Calgon Carbon Corporation (NYSE: CCC) | 31-Mar-17 | $14.25 | $21.50 | 50.9% | 10.8% | 40.1% |
| LRAD Corporation (Nasdaq: LRAD) | 30-Apr-17 | $1.51 | $2.85 | 88.7% | 9.6% | 79.1% |
| Trecora Resources (NYSE: TREC) | 31-May-17 | $10.65 | $9.01 | -15.4% | 12.0% | -27.4% |
| EVINE Live Inc. (Nasdaq: EVLV) | 30-Jun-17 | $1.00 | $0.48 | -51.9% | 8.5% | -60.3% |
| LSI Industries Inc. (Nasdaq: LYTS) | 31-Jul-17 | $8.38 | $2.65 | -68.4% | 7.7% | -76.1% |
| Cooper Tire & Rubber Company (NYSE: CTB) | 31-Aug-17 | $33.80 | $29.87 | -11.6% | 9.2% | -20.9% |
| RealNetworks, Inc. (Nasdaq: RNWK) | 30-Sep-17 | $4.78 | $3.14 | -34.3% | 3.0% | -37.3% |
| NCI Building Systems, Inc. (NYSE: NCS) | 30-Oct-17 | $15.65 | $6.16 | -60.6% | 3.0% | -63.6% |
| TransAct Technologies, Inc. (Nasdaq: TACT) | 30-Nov-17 | $13.60 | $9.20 | -32.4% | -0.6% | -31.8% |
| Regis Corporation (NYSE: RGS) | 30-Dec-17 | $15.36 | $19.66 | 28.0% | 0.0% | 28.0% |
| Team, Inc. (NYSE: TISI) | 30-Jan-18 | $16.95 | $17.50 | 3.2% | -3.0% | 6.3% |
| Andina Acquisition Corp II (Nasdaq:ANDA) | 28-Feb-18 | $9.85 | $4.74 | -51.9% | 1.5% | -53.4% |
| GSE Systems, Inc. (NYSE:GVP) | 31-Mar-18 | $3.25 | $2.80 | -13.8% | 0.4% | -14.2% |
| Telaria, Inc. (NYSE:TLRA) | 30-Apr-18 | $4.13 | $6.34 | 53.5% | -0.4% | 54.0% |
| Avaya Holdings Corp. (NYSE:AVYA) | 31-May-18 | $21.57 | $16.86 | -21.8% | -6.0% | -15.8% |
| Tenneco, Inc. (NYSE:TEN) | 30-Jun-18 | $43.96 | $22.10 | -49.7% | -6.6% | -43.2% |
| Alithya Group Inc. (Nasdaq: ALYA) | 31-Jul-18 | $3.40 | $3.08 | -9.4% | -8.1% | -1.3% |
| Data I/O Corporation (Nasdaq: DAIO) | 30-Aug-18 | $5.37 | $5.55 | 3.4% | -11.4% | 14.7% |
| TPI Composites Inc. (Nasdaq: TPIC) | 28-Sep-18 | $28.55 | $28.55 | 0.0% | -9.5% | 9.5% |
| Shiloh Industries, Inc. (Nasdaq: SHLO) | 31-Oct-18 | $8.59 | $5.43 | -36.8% | 1.6% | -38.4% |
| Richardson Electronics (Nasdaq: RELL) | 30-Nov-18 | $7.18 | $6.80 | -5.3% | 0.1% | -5.4% |
| Universal Electronics Inc. (Nasdaq: UEIC) | 31-Dec-18 | $24.92 | $37.35 | 49.9% | 13.8% | 36.0% |
| CSS Industries, Inc. (NYSE: CSS) | 31-Jan-19 | $8.91 | $6.04 | -32.2% | 2.4% | -34.6% |
| Comtech Telecommunications Corp. (Nasdaq:CMTL) | 28-Feb-19 | $26.25 | $23.20 | -11.6% | -2.6% | -9.1% |
| | | | Average | **13.5%** | **8.3%** | **5.1%** |

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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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