

SPECIAL SITUATIONS

(AND HOW YOU CAN PROFIT FROM THEM)

**LOOKING FOR A NEEDLE
IN A HAYSTACK,
IN A BIGGER HAYSTACK.**

WHAT ARE SPECIAL SITUATIONS?

- Spin-offs
- Restructuring
- Mergers, Acquisitions (M&A)
- Sale of Businesses
- Activist Target
- Anything out of the ordinary that most people don't understand or can't be bothered to research.

DUE DILIGENCE IS KEY

- Background checks on management
- Conference calls, presentation transcripts
- Annual, Quarterly reports
- Accounting policies
- Channel checks
- Comparison with competitors
- Speaking to ex-employees
- Trends in the industry/market research

CASE STUDIES

- Designer Shoe Warehouse (DSW)
Large footwear retailing chain in the U.S
- Lumos Networks (LMOS)
Small telecoms operator

BACKGROUND FACTS ON DSW

- Large shoe retailer in the U.S, focuses 60-70% of merchandise on women's shoes, specifically women's boots.
- Sales are seasonal with 3rd and 4th quarter being the strongest.
- Sells known brands as well as private label with better prices than most high-end competitors peddling the same brands.
- Have made a big push into e-commerce since 2010, allows one to buy or reserve shoes online, and then try them on at the nearest store. Refund process is easy and painless.

SHARE PRICE PLUNGED AFTER 2Q AND 3Q RESULTS

- Q2 slight revenue miss, Town Shoes of Canada showed a small loss, shares down 9%
- Q3 was a hugely disappointing quarter – negative comparable-store sales of (3.9%) compared to generally positive numbers.
- \$10M inventory writedown due to slow-moving merchandise
- However, athletic footwear segment, which is fairly new, jumped 12% in sales.
- Weak tourist traffic in tourist-targeted stores accounted for (0.5%) decline in comparable-store sales.

HMM – INTERESTING.

Massive insider buying from current Executive Chairman + Ex-CEO + Majority owner

Ticker	Owner	Relationship	Date of Transaction	Transaction	Cost/Share	#Shares	Value (\$)	#Shares Total
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	3 Dec 2015	Buy	\$22.79	352,099	\$ 8,025,815	892,099
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	1 Dec 2015	Buy	\$23.06	147,901	\$ 3,411,174	1,000,000
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	28 Aug 2015	Buy	\$28.32	500,000	\$14,160,000	500,000

These purchases came following the poor results, almost immediately after the blackout period.

Note that Jay Schottenstein *already* owns over 70% of the company through direct and indirect methods (two family trusts).

Ticker	Owner	Relationship	Date of Transaction	Transaction	Cost/Share	#Shares	Value (\$)	#Shares Total	Absolute Gains	Gains Annualized
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	3 Dec 2015	Buy	\$22.79	352,099	\$ 8,025,815	852,099	3.86%	469.80%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	1 Dec 2015	Buy	\$23.06	147,901	\$ 3,411,174	1,000,000	2.65%	193.10%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	28 Aug 2015	Buy	\$28.32	500,000	\$14,160,000	500,000	-16.42%	-59.93%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	2 Apr 2015	Option Exercise	\$ -	48	\$ -	32,628	-	-
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	24 Mar 2015	Option Exercise	\$ -	8,865	\$ -	35,165	-	-
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	4 Oct 2013	Sale	\$42.54	9,074	\$ 771,925	0	44.35%	20.41%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	7 Oct 2013	Sale	\$42.54	9,135	\$ 777,206	0	44.36%	20.49%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	2 Oct 2013	Sale	\$42.59	55,367	\$ 4,716,161	0	44.42%	20.40%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	3 Oct 2013	Sale	\$42.56	11,424	\$ 972,297	0	44.38%	20.40%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	30 Sep 2013	Sale	\$42.64	32,592	\$ 2,779,446	0	44.49%	20.37%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	1 Oct 2013	Sale	\$42.78	96,100	\$ 8,222,316	0	44.67%	20.48%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	26 Sep 2013	Sale	\$42.56	53,224	\$ 4,530,427	0	44.38%	20.23%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	23 Sep 2013	Sale	\$42.53	2,581	\$ 219,540	0	44.35%	20.13%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	24 Sep 2013	Sale	\$42.55	21,203	\$ 1,804,375	0	44.37%	20.17%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	18 Sep 2013	Sale	\$42.61	46,000	\$ 3,919,660	0	44.44%	20.05%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	19 Sep 2013	Sale	\$42.58	14,524	\$ 1,236,719	0	44.40%	20.06%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	20 Sep 2013	Sale	\$42.54	7,011	\$ 596,426	0	44.35%	20.06%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	11 Sep 2013	Sale	\$42.56	6,199	\$ 527,597	0	44.38%	19.85%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	5 Sep 2013	Sale	\$43.03	3,166	\$ 272,466	0	44.99%	19.98%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	9 Sep 2013	Sale	\$42.61	13,500	\$ 1,150,335	0	44.44%	19.83%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	5 Dec 2012	Option Exercise	\$ 7.25	99,700	\$ 1,444,643	99,700	-	-
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	5 Dec 2012	Sale	\$34.41	99,700	\$ 6,859,892	0	31.20%	10.39%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	4 Dec 2012	Sale	\$35.40	203,155	\$14,380,649	0	33.13%	11.02%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	29 Nov 2012	Sale	\$34.18	53,700	\$ 3,670,932	0	30.75%	10.18%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	30 Nov 2012	Sale	\$33.93	55,400	\$ 3,758,890	0	30.23%	10.02%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	3 Dec 2012	Sale	\$34.02	74,500	\$ 5,068,980	0	30.42%	10.11%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	26 Nov 2012	Sale	\$34.18	124,500	\$ 8,509,575	0	30.74%	10.15%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	27 Nov 2012	Sale	\$33.99	34,117	\$ 2,318,932	0	30.35%	10.03%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	28 Nov 2012	Sale	\$34.00	154,628	\$10,514,704	0	30.38%	10.05%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	29 May 2012	Sale	\$30.10	390,000	\$23,474,400	0	21.35%	6.06%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	21 Mar 2012	Sale	\$27.95	356,401	\$19,922,816	1,779	15.31%	4.12%
DSW	SCHOTTENSTEIN JAY L	Executive Chairman	22 Mar 2012	Sale	\$26.41	1,658,823	\$87,619,529	0	10.37%	2.80%
DSW	SCHOTTENSTEIN JAY L	Chairman, CEO & President	10 Oct 2008	Buy	\$ 5.50	336,000	\$ 3,696,000	1,292,900	380.18%	110.22%
DSW	SCHOTTENSTEIN JAY L	Chairman, CEO & President	8 Oct 2008	Buy	\$ 6.12	466,700	\$ 5,712,408	770,000	331.54%	95.96%
DSW	SCHOTTENSTEIN JAY L	Chairman, CEO & President	9 Oct 2008	Buy	\$ 5.75	186,900	\$ 2,147,431	956,900	359.70%	104.20%
DSW	SCHOTTENSTEIN JAY L	Chairman, CEO & President	6 Oct 2008	Buy	\$ 5.78	148,800	\$ 1,720,128	148,800	356.92%	103.15%
DSW	SCHOTTENSTEIN JAY L	Chairman, CEO & President	7 Oct 2008	Buy	\$ 6.24	154,500	\$ 1,928,160	303,300	323.24%	93.49%

MANAGEMENT'S REASONS

- Merchandise mis-timing
- **Warmer-than-expected weather**
- Slow response to changing trends
(CEO 'retired' shortly after)

EVALUATING MANAGEMENT'S CLAIMS

Warmer-than-expected weather:

- Similar-sized rival Genesco(GCO) cited similar weather-related headwinds on the conference call, which impacted their results heavily.
- Given 60% of sales comprises of women's boots, DSW was disproportionately impacted by warmer weather relative to peers.

Inventory Mismanagement

- Anecdotal evidence suggests athletic and casual shoes were out of stock in many locations
- Chief Merchandising Officer admitted to the mistake and rectified it with new orders and pulled forward the stocking schedule.

Slow Response To Changing Trends

- CEO retired. New CEO has extensive experience with the company and was in-charge of the successful push into e-commerce.

CATALYSTS

- Late winter on the East Coast
- Resumption of normal operating metrics the next quarter
- More insider-buying (if share price continues falling).
- Take-private offer from management

TAKEAWAYS FROM DSW

- Insider purchases are key, but should always be contextualized.
- Comparison with rivals is a very useful tool, especially if management cites specific problems that can be validated/invalidated by competitors.
- Always have a preliminary exit-plan.

LUMOS NETWORKS (LMOS)

- Company was spun-off from NTELOS (NTLS) in a split of the wireless and wireline assets (Lumos retained the legacy wireline assets)
- Current CEO was a retired, successful telco operator. He was lured out of retirement by Quadrangle partner, who owned 36% of LMOS post-split.
- IPO was under-followed, no analyst coverage for nearly 18 months. Shares surged after as rumors of a sale surfaced.
- Near highs, Quadrangle Partners sold off their stake amidst rumors of a takeover.
- Share price fell and has since languished as the company embarked on a build-out of their fiber network.

RUMORS OF SALE

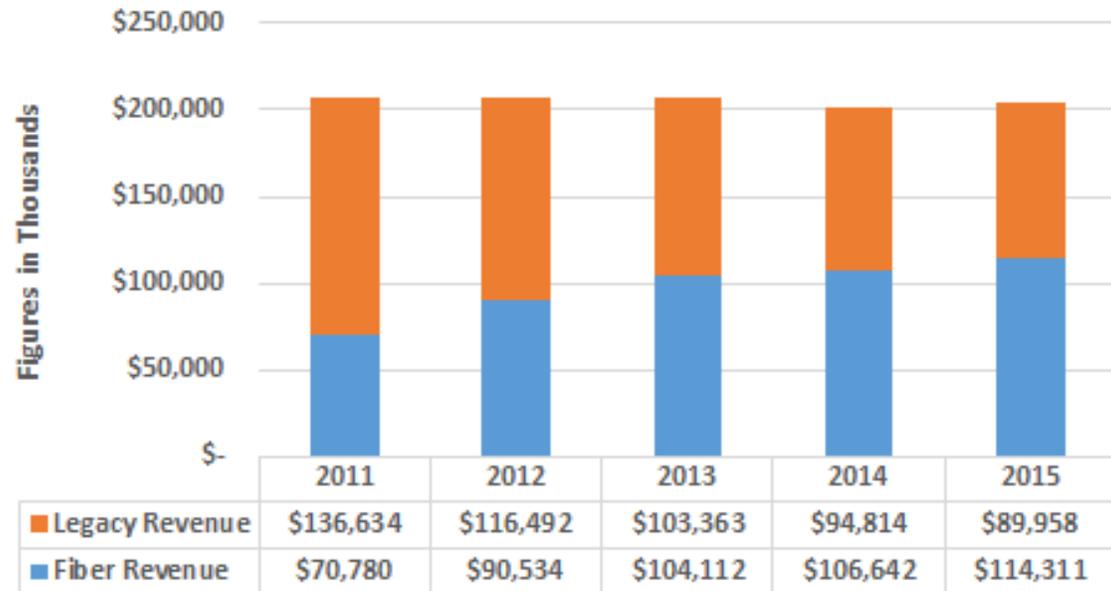
- In mid to late 2013, there were rumors of an impending sale.
- LMOS engaged Wells-Fargo to prep for sale/separation of company and to scout for prospective buyers.
- After a few months, nothing came of it and rumors died down.
- However, LMOS's share price had soared nearly 40% on anticipation of an acquisition.
- Half a year later, Quadrangle Partners sold their stake after CEO recommended to the board to cut the dividend in order to preserve cash for expansion

CEO TIM BILTZ

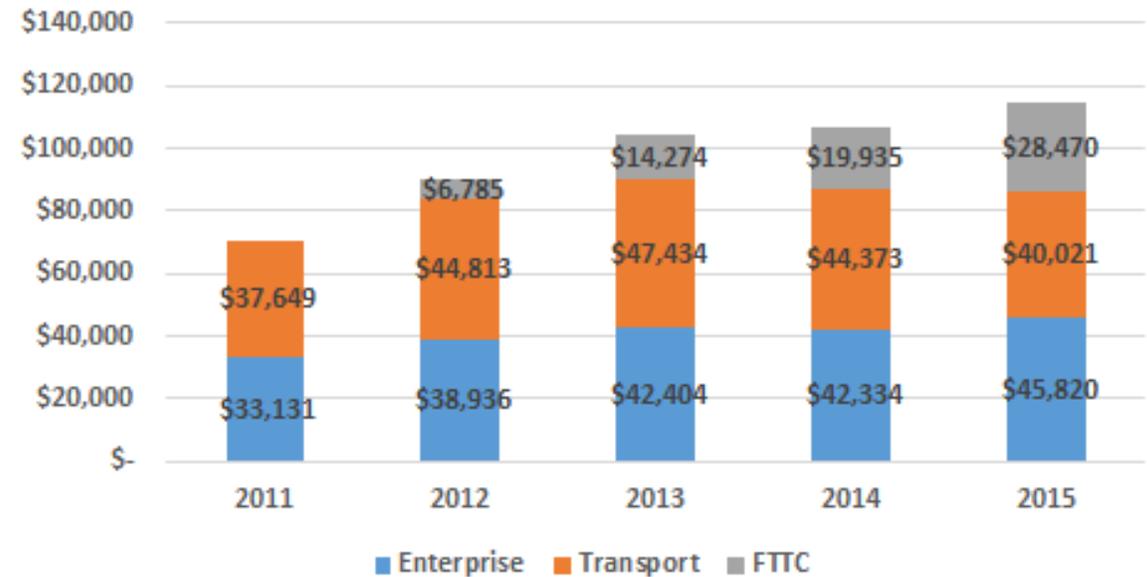
- 35-year career in telecoms.
- Spent time in numerous executive positions.
- Past 2 companies were sold for a substantial premium while he was CEO.
- Track record of long-term value creation – doesn't sell his stock/option grants, only sells stake when companies are sold.
- Was board member of NTELOS since 2007, and retired in 2009.
- Recommended dividend freeze to board even though he personally held over \$40M in stock (dividend yield was ~5%)
- Redirected free cash flow from legacy business to an ambitious fiber expansion.

TRANSITION FROM LEGACY TO FIBER

LMOS: Legacy vs Fiber Revenues



LMOS: Breakdown of Data Revenues



Unlike most legacy wireline operators, LMOS has been successfully transitioning into fiber with little top-line decline, with growth from fiber compensating for the decline in legacy services.

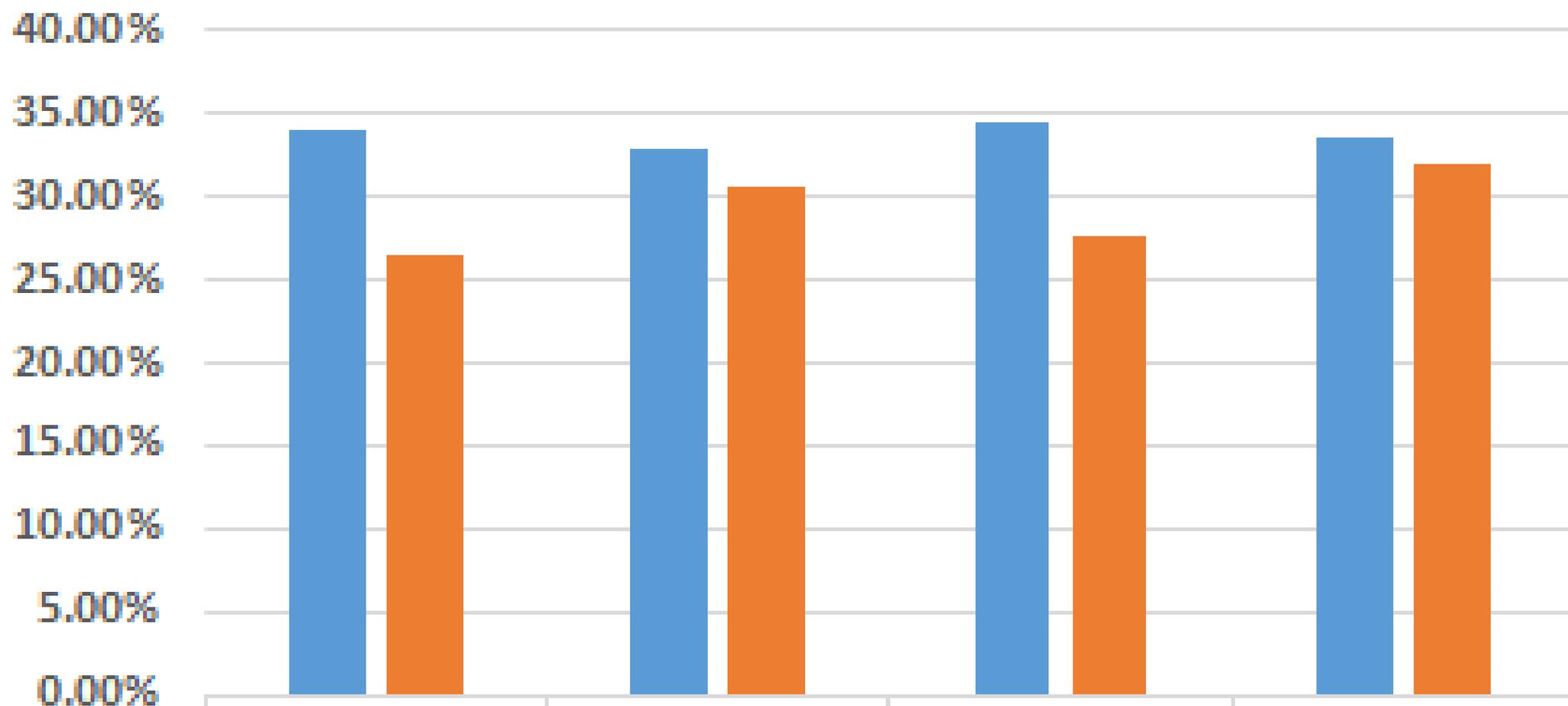
LMOS: Analysis of Guidance vs Results

2013		2014		2015		2016	
Guidance	Results	Guidance	Results	Guidance	Results	Guidance	Results
Reduce network expenses from 22% to 20% of revenue	Achieved - network expenses were 20.4% of revenue in FY2013	\$200M in revenue, \$90M in EBITDA	Both reached. Revenue of \$201M, EBITDA of \$89.9M	\$202M in revenue and \$92M in EBITDA	Exceeded slightly - \$204M in rev and \$92M in EBITDA	\$206 - \$210 in revenue, \$93M-\$96M in EBITDA	
Goal of 550 - 600 FTC sites by end-2013	Exceeded targets - 608 sites installed by end-2013	825 installed FTC sites by end-2014, 1300 FTC sites by 2015Q2	Exceeded targets - 825 unique FTTC sites installed	45% Growth In FTTC Revenues To Reach \$29M At End-2015	Achieved \$28.5M In FTTC Revenues For FY2015	FTTC revenue growth of 34%-37%	
Reduce SG&A from 34% to 31%-32% of revenue - no	Reached in 2014 as SG&A fell to 32.1% of revenue	500 - 700 new FTTC connections by end-2014	Exceeded targets - 735 new FTTC connections sold	1300 new FTTC connections sold by 2015Q2	Exceeded with 1307 FTTC connections	Enterprise revenue growth of 13% - 15%	
Data revenue growth of 15% in 2013	Downward revision to 6%-8% in 2013Q2. Actual growth of 7.2% for FY2013	Transport rev to decline at 6%-8%	Guidance accurate - transport revs declined 6.5%	Enterprise Revenue Growth of 6%	Exceeded guidance, enterprise grew at 8.2%	Data revenue growth of 8%-10%	
				Complete Project Ark and route 100% of FTC traffic by mid-2015	Completed on time	Transport revenue to decline 15%-18%	
				Data revenue growth of 9% in 2015	Revised guidance to 8%-9% in 2015Q2, achieved 8.5% in data rev growth for FY2015	Creation of new pure-play fiber entity	
				1700 new FTTC connections sold by 2015Q4	Missed estimate, failed to secure big deal		

SEPARATION OF FIBER AND LEGACY

- Two segments are already operating as *separate units* internally.
- Management has clearly stated a concrete plan for either a spin-off or partial sale will be drawn up by Q3.
- Consolidation activity has been strong in the wireline industry due to the potential for cost-savings and intensifying competition.
- Referencing similar recent transactions, LMOS is drastically undervalued.
- A number of potential suitors, the strongest possibility is an acquisition by Zayo Group (ZAYO)

LMOS: Margins For R&SB Segment



■ Gross Margin

34.07%

33.00%

34.54%

33.60%

■ Operating Margin

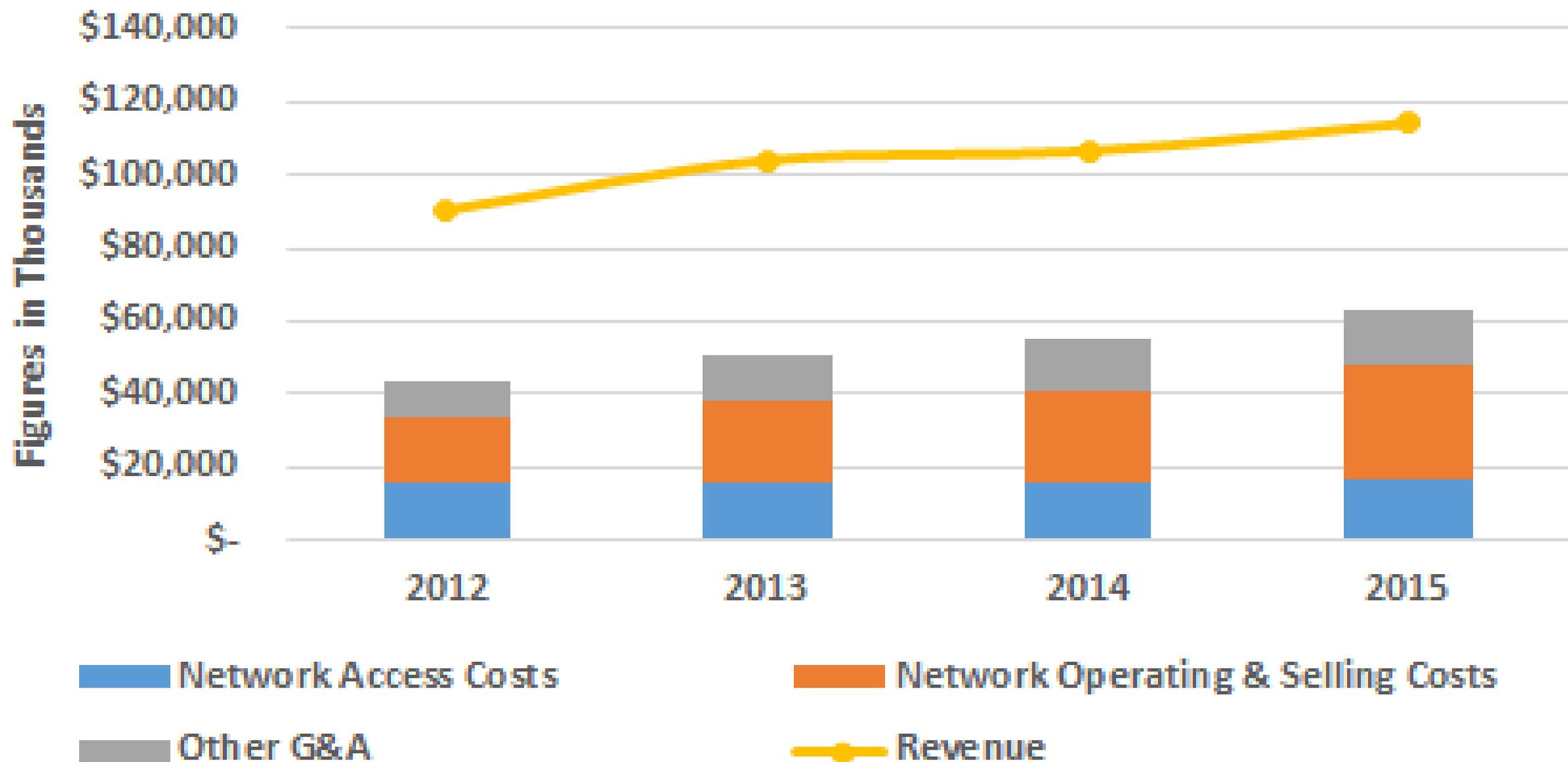
26.60%

30.57%

27.63%

32.07%

LMOS: Data Segment



RLEC Segment

<i>Figures in Thousands</i>	2012	2013	2014	2015
Revenue	\$ 24,117	\$ 22,704	\$ 22,786	\$ 22,744
Network Access Costs	\$ -	\$ -	\$ -	\$ -
Network Operating & Selling Costs	\$ 3,167	\$ 1,850	\$ 1,544	\$ 1,058
Other G&A	\$ 3,550	\$ 2,693	\$ 3,003	\$ 2,713
Operating Income	\$ 17,400	\$ 18,161	\$ 18,239	\$ 18,973
CapEx	\$ 597	\$ 1,634	\$ -	\$ -

VALUATION

Blended Multiple

Legacy Peer Group		
	Ticker	EV/EBITDA
Frontier Communications	FTR	10.2
Consolidated Communications	CNSL	10.0
Earthlink	ELNK	5.2
Windstream Corp	WIN	3.2
CenturyLink	CTL	5.5
Median		5.5
Fiber Peer Group		
Cogent Communications	CCOI	16.1
Zayo Group Holdings	ZAYO	16.1
Median		16.1

Weighting the multiples using revenues from the data and legacy segment, LMOS should be valued at 11.84x EV/EBITDA (currently trading at 7.40x EV/EBITDA)

Acquisition Value

- ZAYO has made over 33 fiber acquisitions since 2009.
- Most of them (as recent as 3 months ago) have been made at an EV/EBITDA multiple of 11-13x.
- This implies LMOS is undervalued by roughly 50% (the value of the legacy segment would be derived with a basic DCF model).
- Since LMOS generates much higher margins (85% vs. 50-60% gross) compared to ZAYO, they should be valued at even higher multiples.

CONCLUSION

- Timeframe: 6 – 18 months
- Expected Gain: 35% – 55% gain on LMOS equity.
- Will also consider selling puts if implied volatility rises.
- Key metrics to watch: CapEx spend, sales ramp for data segment, commentary on fiber and legacy separation.
- Risk Factors: Slow sales ramp, higher-than-expected CapEx, longer-than-expected separation process, lack of prospective buyers, legal issues.