

The Road Less Traveled: Special Situations Investing

Using Technology to Screen for Special
Situations

Buckley Capital Partners

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Introduction

- Well-designed screens are a powerful tool to aid value investors in their search for bargains
- Often allow you to identify opportunities overlooked by the rest of the market
 - By spotting, researching, and investing in these before others, you can beat the market substantially over time
- Today I will discuss companies I currently own or previously owned in order to highlight the investment opportunity and how I discovered it (keep in mind I did not always trade the companies as well as the charts indicate)

History of Technology Use

- Investing has evolved greatly over the years
 - 1930s: value investing is born as the Graham-Newman partnership buys “net-nets”
 - 1950s-70s: Warren Buffett continues the “net-net” approach, using Moody’s stock guide to manually find opportunities
 - 1962: Compustat launches first financial data source
 - 1996: all SEC filings become available online
 - Late 1990s: arrival of internet provides widespread access to free financial data
 - Today: immediate information and advanced screening capabilities make finding ideas easier than ever before

Taking advantage of technological progress is now a critical tool to gaining an ‘edge’ over the market

Special Situation Screens

- One particularly useful family of screens are special situation screens
 - Generally search for a particular event rather than on traditional valuation metrics
 - Technological advances have greatly reduced the legwork they involve

<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> screeningalerts	Idea Screens buyback - buyback screen (Company Screen) Alert Frequency: Daily(Every Day) Last Alert Date: Feb-28-2014	Mar 1
<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> screeningalerts	Idea Screens M&A - M&A Alert Frequency: Daily(Every Day) Last Alert Date: Feb-28-2014 Screen Criteria View Screen	Mar 1
<input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/> screeningalerts	Idea Screens 13d's - 13d's Alert Frequency: Daily(Every Day) Last Alert Date: Feb-28-2014 Screen Criteria View	Mar 1
<input type="checkbox"/> <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> screeningalerts	Idea Screens Companies down 40% - Companies down 40%+ last 3M (Equity Security Screen) Alert Frequency: Daily(Every D	Mar 1

Source: Capital IQ

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Idea Generation

I think these types of screens can be particularly useful today with the market near all-time highs and many stocks approaching fair value

Column Heading	Parameter Detail	Passed 100	Available 1423
5. Working Capital	FG_CUR_ASSETS(0)-FG_CUR_LIAB S(0)	DISPLAY	DISPLAY
6. Net PP&E	FG_PPE_NET(0)	DISPLAY	DISPLAY
7. Return on Capital	ROW4/(ROW5+ROW6)*100	DISPLAY	DISPLAY
8. Earnings Yield Rank	RANK(ROW3)	DISPLAY	DISPLAY
9. ROC Rank	RANK(ROW7)	DISPLAY	DISPLAY
10. Overall Rank	RANK(-(ROW8+ROW9))<=100S	100	1161

Source: Factset

Joel Greenblatt: Special Situation Guru

- Joel Greenblatt

- Co-founder of the Value Investor's Club and a past conference speaker
- Compounded capital at 50% per year from 1985-1994 largely by investing in special situations



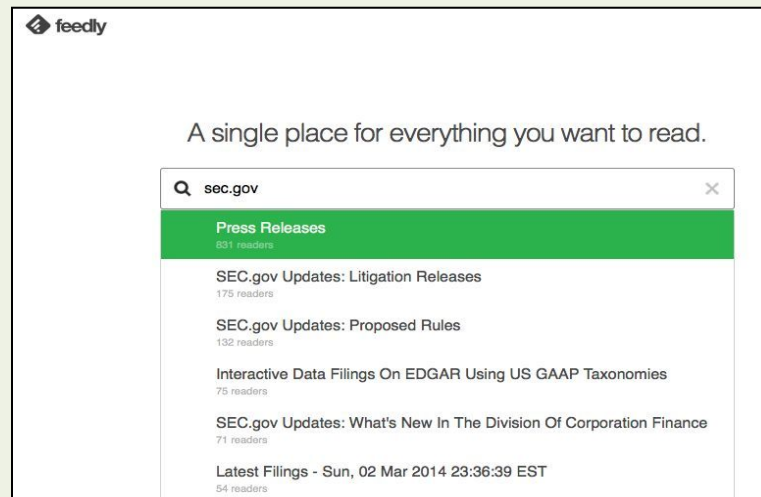
*“If you spend your energies looking for and analyzing situations not closely followed by other informed investors, your chance of finding bargains greatly increases. **The Trick is locating those opportunities**”*

Source: You Can Be A Stock Market Genius

Today's Opportunities

- Several types of special situation opportunities (such as spinoffs and rights offerings) are discussed in Joel's excellent book "You Can Be a Stock Market Genius"
- I personally try to follow all special situations **that I think will yield at least one good investment opportunity per year**
- Today I will discuss a variety of additional sources of opportunity within the special situation space
 - Strategic Alternatives/M&A
 - Activist Investors
 - Insider Buying
 - 13 D/G Filings
 - Value Investor's Club website
 - Buybacks
 - NT 10 Q/K
 - Dutch Tenders
 - Delistings

SPECIAL SITUATION SCREENING OVERVIEW



The screenshot shows the Feedly search results for 'sec.gov'. The interface includes the Feedly logo, a search bar with the text 'sec.gov', and a list of search results. The top result is 'Press Releases' with 201 readers. Other results include 'SEC.gov Updates: Litigation Releases' (175 readers), 'SEC.gov Updates: Proposed Rules' (132 readers), 'Interactive Data Filings On EDGAR Using US GAAP Taxonomies' (75 readers), 'SEC.gov Updates: What's New In The Division Of Corporation Finance' (71 readers), and 'Latest Filings - Sun, 02 Mar 2014 23:36:39 EST' (54 readers).

Source: Feedly

Source: Factset



The screenshot shows the Factset Events/News section. The header is 'Events/News'. The list of events includes: 'FAS 123 Quarterly EPS Impact - FactSet Consensus', 'Insider Buys in the Last 3 Months', 'Corporate Governance Red Flags', '1 Week EPS Estimate Revisions - FactSet Consensus', 'EPS Reported Yesterday - FactSet Consensus', and 'EPS Expected to Report in Next Seven Days - FactSet Consensus'.

STRATEGIC ALTERNATIVES AND M&A

Strategic Alternatives and M&A

- Announcement that a company is considering or actively seeking to make a major change in their business
 - Selling a division
 - Selling entire company
- Information sources: Capital IQ, Bloomberg, Factset, and Google Alerts

Examples

Alert Frequency: Daily(Every Weekday) | Last Alert Date: Feb-19-2014

Screen Criteria [View Screen Builder >>](#)

1 - Market Capitalization [Latest] (\$USDmm, Historical rate): is between 25 and 2000

2 - Geographic Locations: United States and Canada (Primary)

3 - Key Developments by Type: Seeking to Sell/Divest OR Considering Multiple Strategic Alternatives OR Index Constituent Drops OR Potential Buyback [Last 7 Days]

Companies Added to Results (4)

[Anaren, Inc.](#); [BCSB Bancorp, Inc.](#); [Hollywood Media Corp. \(OTCPK:HOLL\)](#); [Huntingdon Capital Corp \(TSX:HNT\)](#)

Google

strategic alternatives

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Search tools

About 5,280 results (0.17 seconds)



MarketWatch

[World Energy Solutions \(XWES\) to Review **Strategic Alternatives**](#)

[StreetInsider.com \(subscription\)](#) - 2 hours ago

World Energy Solutions, Inc. (Nasdaq: XWES), a leading energy management services firm, today announced that representatives of the ...

[CafePress Inc \(PRSS\) news: CafePress Considers **Strategic ...**](#)

[Seeking Alpha](#) - Feb 18, 2014

CafePress (PRSS) hired an investment bank, Raymond James & Associates (RJF), to explore **strategic alternatives** and potential sale of the ...

Source: Google
Source: Capital IQ

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Case Study: Mindspeed

- Mindspeed Technologies (MSPD)
 - Designer and developer of communication semiconductor solutions
 - Announced in April 2013 that they had hired a financial advisor to assist in a review of strategic alternatives
 - Management even disclosed that they had been approached by potential buyers
 - Intrinsic value was \$5.00+/share

The logo for Mindspeed Technologies, featuring the word "MINDSPEED" in a bold, sans-serif font. The letter "M" is orange, and the rest of the letters are grey. A registered trademark symbol (®) is located to the right of the word.

Market Cap (M):	\$119.4
Shares Outstanding (M):	43.2

Strategic Alternatives Case Study

- This information was available nearly six months in advance, giving people plenty of time to find and research the opportunity

Alert Frequency: Daily(Every Weekday) | Last Alert Date: Apr-30-2013

Screen Criteria [View Screen Builder >>](#)

1 - Market Capitalization [Latest] (\$USDmm, Historical rate): is between 25 and 2000

2 - Geographic Locations: United States and Canada (Primary)

3 - Key Developments by Type: Seeking to Sell/Divest OR Stock Splits & Significant Stock Dividends OR Considering Multiple Strategic Alternatives OR Index Constituent Drops OR Potential Buyback [Last 7 Days]

Companies Added to Results (4)

[Dex Media \(NasdaqGS:SPMD\)](#); [ESB Financial Corp. \(NasdaqGS:ESBF\)](#); [K-Swiss Inc. \(NasdaqGS:KSWS\)](#); [Mindspeed Technologies Inc. \(NasdaqGS:MSPD\)](#)

Source: Capital IQ

Result

- Mindspeed was bought out in November at nearly a 70% premium to the previous closing price



Source: Google Finance

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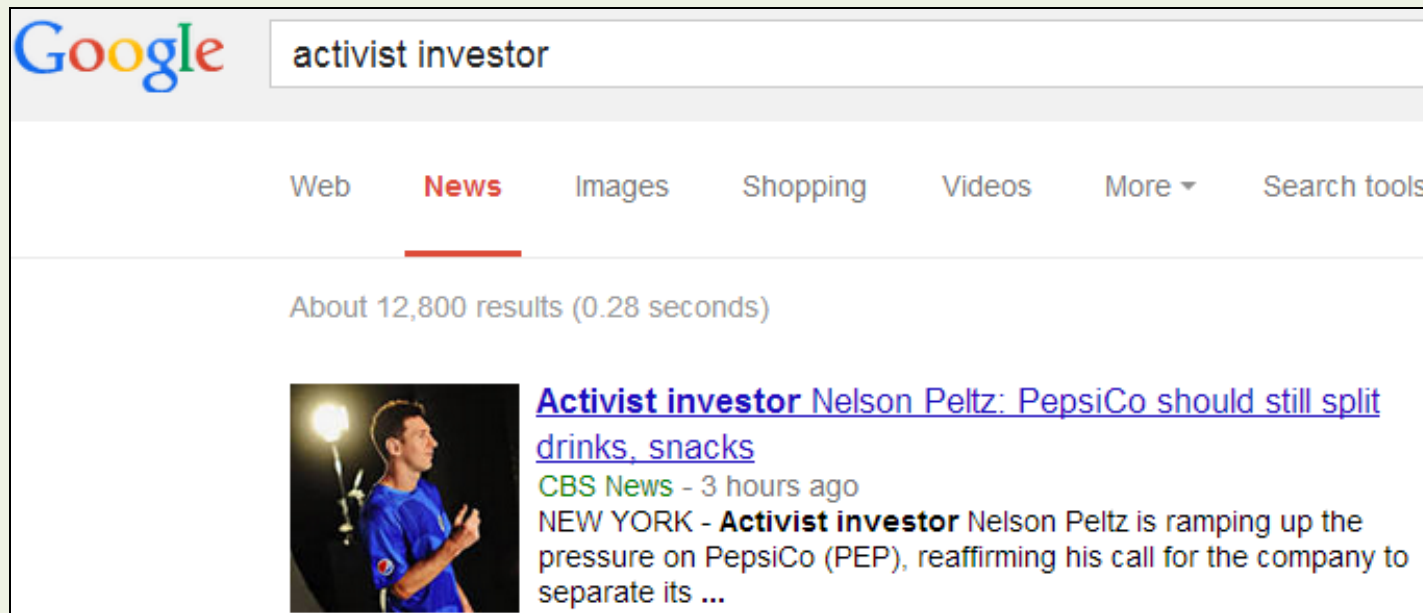
ACTIVIST INVESTORS

Activist Investors

- Use their equity ownership of a corporation to put public pressure on management
 - Often propose specific suggestions for value creation or request a seat on the company's Board of Directors
- Their influence can be a catalyst for company actions that unlock substantial value

How To Find Opportunities

- Information sources: Capital IQ, Bloomberg, Factset, and Google Alerts



Source: Google

Case Study: Xyratex

- In October 2012, Baker Street initially filed a 13D disclosing a XRTX position (then at 14%) at adjusted \$6.30/share
- The following January, they filed another 13D that showed they now owned 23% of XRTX shares
 - Also sent a public letter with this filing to the Board of Directors that made the case for why the company's stock was significantly undervalued, and suggested several alternatives to rectify the situation



Market Cap (M):	\$230
P/TBV:	0.7
Shares Outstanding (M):	27.7

Dear Members of the Board,

Baker Street Capital Management, LLC, together with its affiliates ("Baker Street"), is the largest shareholder of Xyratex Ltd ("Xyratex" or the "Company"), owning approximately 23% of the Company's outstanding common shares. As we outlined in our private letter to the Board of Directors (the "Board") on December 21, 2012, we believe that Xyratex is significantly undervalued by the market and faces serious self-inflicted issues that are depriving shareholders of the full value of their investment.

Activist Case Study

- In April of 2013, Baker Street was granted two seats on the XRTX board
- Shortly after, the company stated in a filing that it had formed a Strategic Committee to evaluate possible alternatives

Thus, this opportunity could have been found through a 13 D/G screen, a strategic alternatives screen, or an activist screen

Result

- Result: in December 2013, less than a year from the initial letter, Xyratex was acquired at a roughly 30% premium to its last closing price
 - Including the special dividend paid at the end of 2012, the total shareholder return was over 100% in just over a year



Source: Google Finance

INSIDER BUYING

Insider Buying

- When insiders (generally the most knowledgeable people about a given company) acquire stock, it can be a bullish sign
 - Indicates they believe the stock to be undervalued
 - Actions speak louder than words- many management teams tout their company, but fewer are willing to risk their own money on it
- If you find a high quality company, insider buying is a strong signal that the current price is attractive


How To Find

- Senior management is required to report all transactions to the SEC (Form 4)
- Information sources: Insiderscore.com. Insidercow.com, secform4.com, sec.gov RSS feed, Capital IQ, Bloomberg, Factset, and Google Alerts

Free finance websites (such as Yahoo Finance) also provide this information, but they are generally less reliable

Examples

#	Symbol	Company	Cap	Insider (Position)	Insider IQ	Type	Event	Score	Shares	Price	Value	Owned	In Shares	Filed	Filing
1	THR	Theravance	\$4.3B	Plc Glaxosmithkline (10% Owner)	*	BUY		1.3	342.2K	\$37.55	\$12,850.7K	30.3M	+1.1%	04:42 PM	4
2	EBIO	Eleven Bioth...		-Flagship Ventures Fund... (10% Owner)	-	BUY		2.4	378.7K	\$10.00	\$3,787.3K	3.4M	+12.6%	06:56 PM	4
3	SFLY	Shutterfly	\$1.8B	Nancy J. Schoendorf (Director)	-	BUY	Buy Reversal	1.1	15.0K	\$44.71	\$670.6K	67.4K	+28.6%	04:06 PM	4
4	JEC	Jacobs Engin...	\$7.9B	Christopher M.T. Thompson (Director)	-	BUY		0.7	10.0K	\$60.71	\$607.1K	10.0K	New	04:08 PM	4
5	AYR	Aircastle	\$1.5B	Marubeni Corp... (Director)	-	BUY		0.2	30.0K	\$18.58	\$557.5K	16.1M	+0.2%	06:07 AM	4



Search for Current Events

Which day would you like to analyze?

- Most Recent (t)
- One business day prior (t-1)
- Two business days prior (t-2)
- Three business days prior (t-3)

Which form series would you like to see?

- 10-K - Annual
- 10-Q - Quarterly
- 14 - Proxies, etc.
- 485 - Fund Prospectuses

Enter a form ID to override the list above:

To run the request, press this button:

Source: Insiderscore.com

Source: SEC.gov

Case Study: Radiant Logistics

- In November 2012, the CEO of transportation services company Radiant Logistics (RLGT), Bohn Crain, filed a Form 4 disclosing the purchase of additional shares of stock
 - Notable because the stock was near multi-year lows
 - By buying aggressively, he indicated his faith in the company's future
 - A buyback (another useful signal discussed later) was also announced around this time



Market Cap (M):	\$45.7
EV/FCF:	8.5
Shares Outstanding (M):	36

2012-11-27 Purchase	2012-11-29 09:53 am	RADIANT LOGISTICS, INC	RLGT	CRAIN BOHN H (Chief Executive Officer Director 10% owner)	31,600	\$1.269	\$40,100	9,157,462 (Indirect)	View
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RLGT Insider Buying History

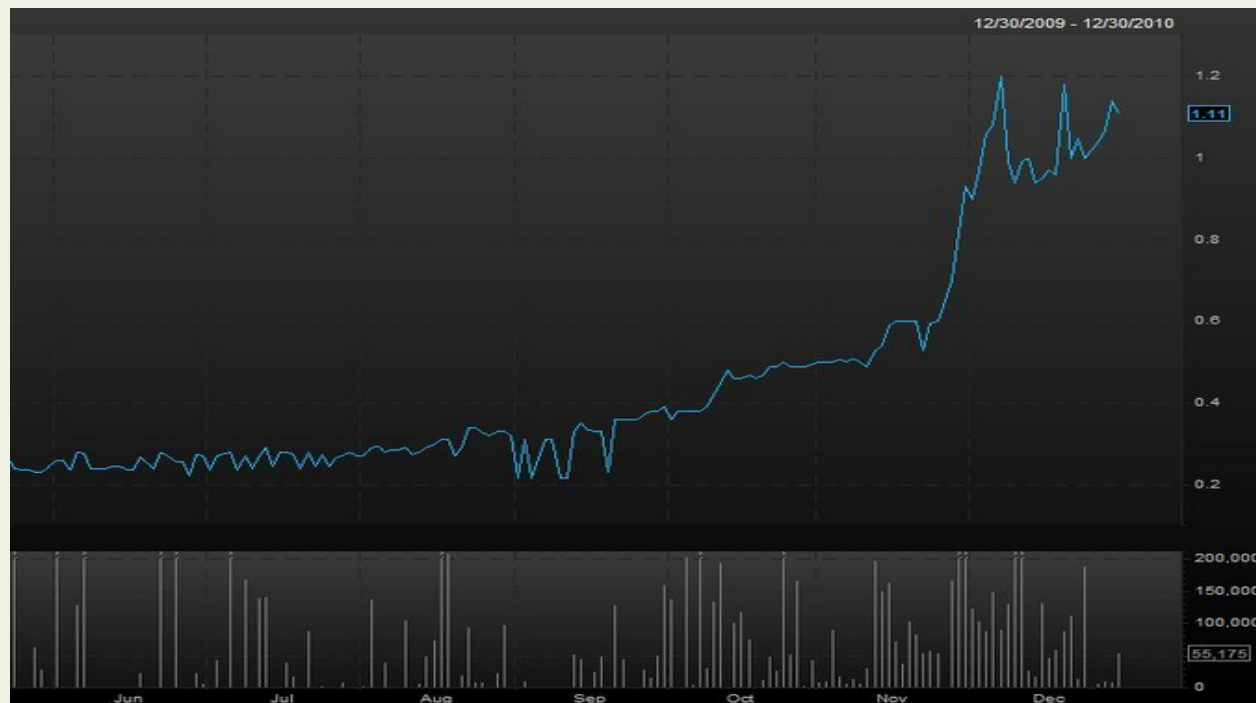
- Furthermore, Crain had a history of making savvy and opportunistic purchases
 - Also purchased when stock was near all-time lows in 2009 and 2010

2010-05-24 Purchase	2010-05-26 4:07 pm	RADIANT LOGISTICS, INC	RLGT.OB	CRAIN BOHN H (Chief Executive Officer Director 10% owner)	185,000	\$0.27	\$49,950	8,955,000 (Indirect)	View
2010-02-22 Purchase	2010-02-23 08:04 am	RADIANT LOGISTICS, INC	RLGT.OB	CRAIN BOHN H (Chief Executive Officer Director 10% owner)	200,000	\$0.23	\$46,000	8,770,000 (Indirect)	View
2009-10-07 Purchase	2009-10-07 4:05 pm	RADIANT LOGISTICS, INC	RLGT.OB	CRAIN BOHN H (Chief Executive Officer Director 10% owner)	70,000	\$0.25	\$17,500	70,000 (Indirect)	View

Source: SECform4.com

2009 Insider Purchases and Results

- Within months of his 2009/2010 purchases, RLGT was a 4-bagger



Anyone who recognized this would have viewed his November 2012 buying as a very bullish signal

Results: Second Time Around

- Result: anyone who recognized the dip as a buying opportunity has been handsomely rewarded over the past 17 months



Source: Google Finance

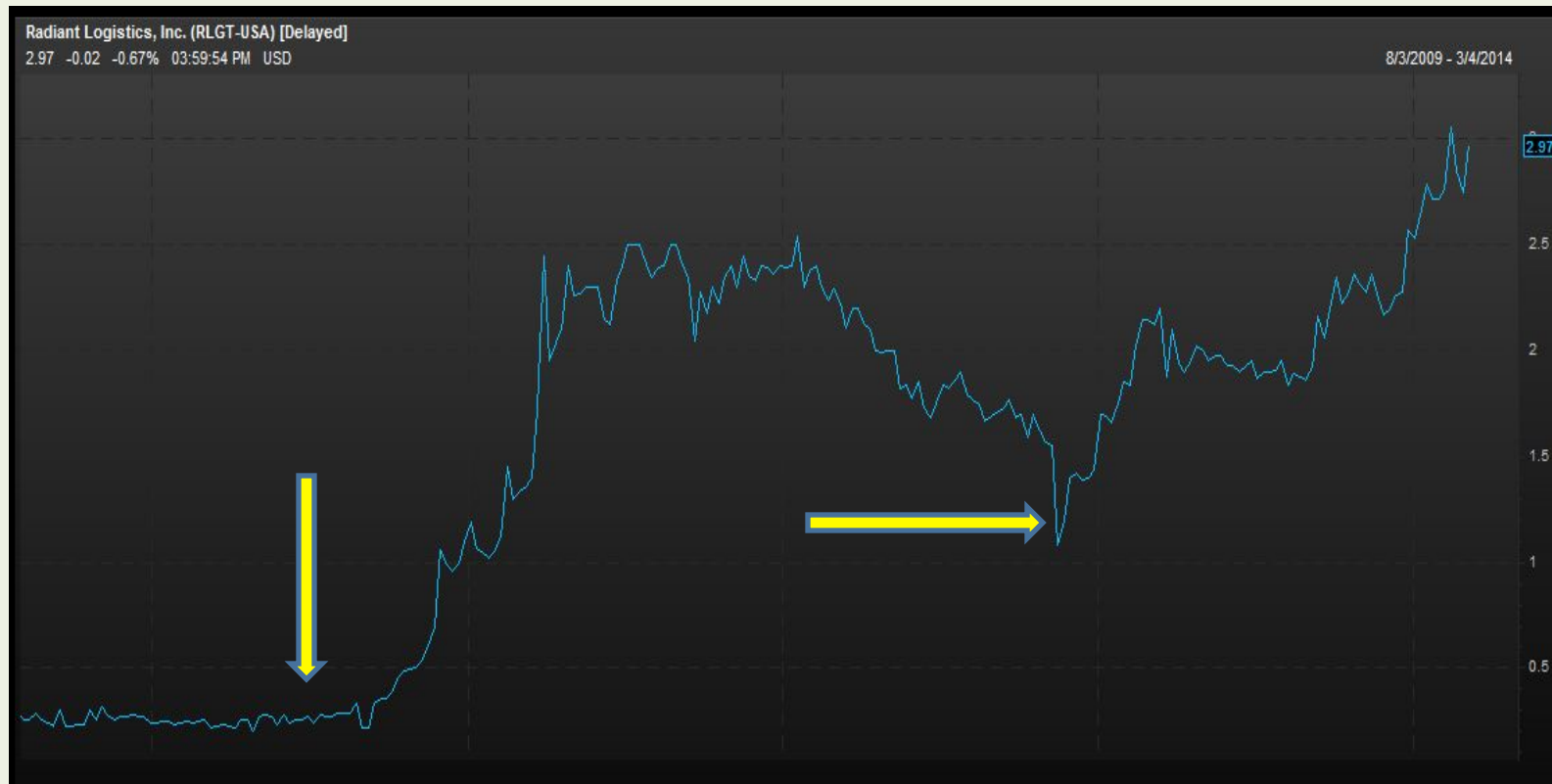
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History Repeats Itself

- Two bites at the apple



Source: Factset
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13 D/G FILINGS

13 D/G Filings

- SEC filing that requires reporting of ownership changes by anyone who holds more than 5% of a publicly-traded security
- Tracking these filings can alert you when smart shareholders find a company attractive enough to take a substantial stake in it

How To Find Them

- Information sources: Insiderscore.com, Capital IQ, Bloomberg, Factset, SEC.gov RSS feed, Google Alerts

5	<u>DARA</u>	-	DARA Bioscie...	\$16.3M	<u>Alpha Capital Aktienge...</u>	(592.0K)	7.7%	651.0K	-47.6%	12:35 PM	<u>13G/A</u>
6	<u>LCAV</u>	-	LCA-Vision	\$107.6M	<u>Joern S. Joergensen</u>	210.7K	4.8%	918.1K	+29.8%	11:19 AM	<u>13D/A</u>
7	<u>CCRN</u>	-	Cross Countr...	\$331.7M	<u>Charterhouse Equity Pa...</u>	(2.5M)	-	-	-100.0%	11:14 AM	<u>13G/A</u>
8	<u>APAGF</u>	-	Apco Oil and...	\$442.2M	<u>Utility Service Holdin...</u>	(91.7K)	2.2%	636.2K	-12.6%	10:12 AM	<u>13G</u>
9	<u>ALLT</u>	-	Allot Commun...	\$540.4M	<u>Psaqot Investment House</u>	91.5K	5.8%	1.9M	+5.1%	06:21 AM	<u>13G/A</u>

Utilizing 13D/G Filings to Your Advantage

- Once you see a shareholder with a strong track record taking a 5%+ position, it's often worth spending some time understanding what the investment thesis is
 - Do your own work: everyone is wrong at times, if you're not comfortable with the situation just wait for the next opportunity
 - “There are no called strikes on Wall Street”

Case Study: Startek

- Startek, Inc. (SRT)
 - Provider of business process outsourcing services
 - In March 2012, a 13D filing indicated that the Privet Fund had taken a 19% stake in the company



Market Cap (M):	\$33.8
EV/FCF:	n/a
Shares Outstanding (M):	15.2
TTM Revenues (M):	\$220M
EBITDA Margin	8%

1. Privet Fund LP

Trade Date	Nature of Transaction (Purchase/Sale)	Number of Shares	Price Per Share ¹
3/1/2012	Purchase	29	\$ 2.0300
3/1/2012	Purchase	700	\$ 2.0500
3/1/2012	Purchase	1,000	\$ 2.0550
3/1/2012	Purchase	200	\$ 2.0575

Based on Privet's strong track record, it made sense for individuals to try to understand their reasoning and see if they agreed

A Very Cheap Business

- It was quickly apparent that the business was indeed very cheap
 - EV/TTM Normalized EBITDA* = 1.4
 - SRT was also trading well below tangible book value (0.5x), providing substantial downside protection and minimizing the risk of permanent capital loss

*Normalized EBITDA based off 8% EBITDA margins

Result

- Result: anyone who took the time to understand the situation was richly rewarded
 - SRT has more than tripled since the filing date



The stock could have also been found by anyone running the insider buying screens discussed earlier, as the SRT CEO was also buying around the same time

VALUE INVESTOR'S CLUB WEBSITE

Value Investor's Club website

- Investment website where high-quality value and special situation ideas are shared on a daily basis (<http://www.valueinvestorsclub.com/value2/>)
 - It requires a membership, but guests can access all ideas 45 days after their initial posting date
 - Many theses remain fully intact even after this delay
 - For example, Mindspeed (which I myself found on VIC) could have been seen and profited from by a guest



BUYBACK

Buyback

- Occurs when a company decides to repurchase its own shares on the open market
- Like insider buying, it often indicates that management believes the stock to be undervalued

How To Find

- Information sources: Capital IQ, Bloomberg, Factset, and Google Alerts

Company	Sector	Average Buyback Price	Average Stock Price	Buyback Price / Avg Price	1 Year Total Return
Electronic Arts Inc.	Information Technology	\$12.98	\$19.24	67.5%	44.2%
Thermo Fisher Scientific Inc.	Health Care	\$63.01	\$77.19	81.6%	60.3%
IntercontinentalExchange Group	Financials	\$128.48	\$156.64	82.0%	74.0%
Starbucks Corporation	Consumer Discretionary	\$50.52	\$60.15	84.0%	45.2%
Regeneron Pharmaceuticals	Health Care	\$179.13	\$208.48	85.9%	49.4%
Seagate Technology PLC	Information Technology	\$30.73	\$36.24	84.8%	90.9%
Gilead Sciences, Inc.	Health Care	\$41.36	\$47.47	87.1%	92.4%
Chipotle Mexican Grill, Inc.	Consumer Discretionary	\$294.73	\$338.15	87.2%	85.9%
The NASDAQ OMX Group, Inc.	Financials	\$25.05	\$29.12	86.0%	62.5%
Danaher Corporation	Industrials	\$51.96	\$61.00	85.2%	38.3%
S&P 500	-	\$66.17	\$63.22	99.8%	28.6%

Source: Factset

Companies usually issue a press release after the Board approves a share repurchase program, so a news search will also turn up many relevant results

Case Study: Franklin Covey

- In June 2012, training and consulting services provider Franklin Covey (FC) initiated a \$10 M buyback
 - Inexpensive stock price (about 8.5x cash flow for a growing, high quality business)



Market Cap (M):	\$140.5
EV/FCF:	12.8
Shares Outstanding (M):	15.6

SALT LAKE CITY--(BUSINESS WIRE)--Jul. 24, 2012-- Franklin Covey Co. (NYSE: FC): In March of 2012, the Franklin Covey Co. Board of Directors approved a stock repurchase program to repurchase up to \$10 million of its outstanding shares of common stock. The shares repurchases may be made from time-to-time through open market transactions, block trades, privately negotiated transactions, or otherwise, and are subject to market conditions, as well as corporate, regulatory, and other considerations.

The Company is pleased to announce that today it initiated stock repurchases under the program.

Result

- Result: the combination of strong execution (leading to increased investor demand) and fewer shares outstanding (reduced supply) have had a very favorable effect on the stock price – a roughly 133% gain



Source: Google Finance

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NT 10-Q/K

NT 10-Q/K

- Filed when a company cannot submit its required quarterly or annual report by the SEC's deadline in a timely manner
- This disruption can induce a short-term market panic that can provide bargain opportunities for value investors
- Important that the restatement does not materially impact the intrinsic value of the business

How To Find

- Information sources: sec.gov
RSS feed, Capital IQ, Bloomberg, Factset, and Google Alerts



The screenshot shows the SEC EDGAR search interface. At the top left is the SEC logo. The main heading is "Search for Current Events". Below this is the question "Which day would you like to analyze?". A dropdown menu is open, showing four options: "Most Recent (t)", "One business day prior (t-1)", "Two business days prior (t-2)", and "Three business days prior (t-3)". The "Three business days prior (t-3)" option is highlighted in blue. Below this is the question "Which form series would you like to see?". A dropdown menu is open, showing four options: "10-K - Annual", "10-Q - Quarterly", "14 - Proxies, etc.", and "485 - Fund Prospectuses". Below the dropdowns is a text input field with the label "Enter a form ID to override the list above:" and the value "NT 10-Q". At the bottom right is a "Submit" button.

Source: SEC.gov

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Case Study: Diligent Board Member Services

- Diligent Board Member Services (DIL NZ)
 - Board communication tool provider trading in New Zealand (though also registered with SEC because management is based in the US)
 - Misclassified the timing of revenue recognition leading to a restating of financials
 - This was first announced in August 2013
 - Was initially supposed to be completed in mid-December 2013, but later announced that this would be delayed due to the complexities of the process
 - Announced free cash flow would not change



Market Cap (M USD):	\$485.1
EV/FCF:	14.3
Shares Outstanding (M):	122.5

Results of Inability to File on Time

- As a result, DIL dropped nearly 50%



Source: Bloomberg

Selloff Is Overdone - A Rally Follows

- As often occurs, the selloff proved overdone and DIL rallied strongly soon after



Source: Bloomberg

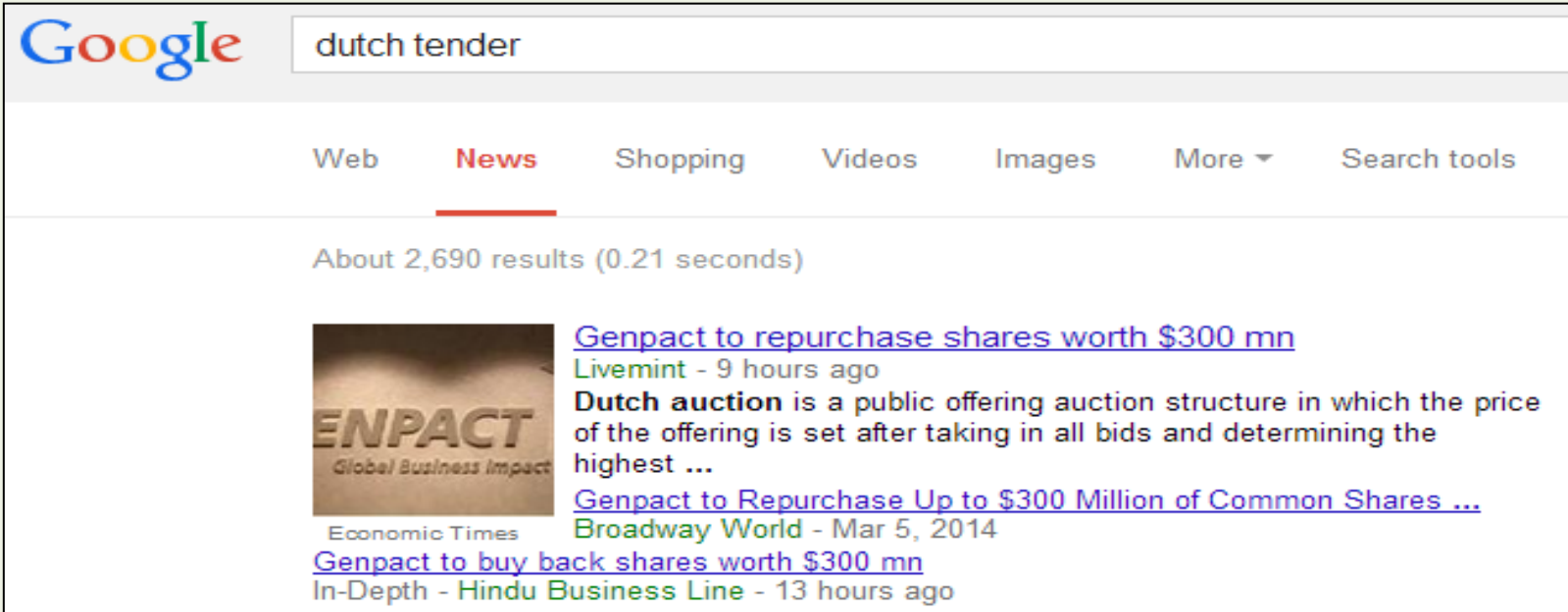
DUTCH TENDER

Dutch Tender

- Specialized type of buyback
 - Company specifies the price range at which they are willing to repurchase shares
 - Shareholders are then invited to tender their stock, if desired, at any price within the range
 - Will then buy stock at lowest price that allows firm to their desired share quantity

How To Find

- Information sources: Capital IQ, Bloomberg, Factset, and Google Alerts



The screenshot shows a Google search interface. The search bar contains the text "dutch tender". Below the search bar, the "News" tab is selected and highlighted with a red underline. The search results are displayed below the tabs, showing "About 2,690 results (0.21 seconds)". The first result is a news article from Livemint, titled "Genpact to repurchase shares worth \$300 mn", dated 9 hours ago. The article snippet reads: "Dutch auction is a public offering auction structure in which the price of the offering is set after taking in all bids and determining the highest ...". Below this, there are two more results: one from Broadway World dated Mar 5, 2014, titled "Genpact to Repurchase Up to \$300 Million of Common Shares ...", and one from Hindu Business Line dated 13 hours ago, titled "Genpact to buy back shares worth \$300 mn". A small image of the ENPACT logo is visible on the left side of the first result.

Source: Google

Case Study: Tucows

- Tucows (TCX)
 - Canadian internet services company with a rapidly growing and valuable hidden asset called Ting
 - While the company did not look incredibly cheap on an EV/FCF basis, it was very cheap because of the value of Ting
 - Have successfully executed several Dutch Tender offers in recent years
 - In November 2012, TCX announced a tender to repurchase up to 6.5 M shares
 - In the end, the company bought back over 9% of their shares outstanding
 - The move was particularly accretive because TCX purchased them at a 7% discount to their current market value



Market Cap (M):	\$61.5
EV/FCF:	12.9
Shares Outstanding (M):	11.1

Result

- Result: smart capital allocation and the market's realization of the value in Ting has helped TCX more than double from the date the tender offer was announced



Source: Google Finance

DELISTINGS

Delistings

- Occurs when company is removed from the exchange on which they were previously trading
 - Not in compliance with index listing requirements
- Often causes the market to fear a serious problem at the company, as well as forced selling by index funds and strict-mandate mutual funds
- Information sources: sec.gov RSS feed, Capital IQ, Bloomberg, Factset, and Google Alerts

Sell-offs for technical reasons (not business related) often create excellent buying opportunities

A Current Opportunity: Avid Technology

- Avid Technology (AVID)
 - Provider of digital media content creation solutions
 - Incorrectly accounted for certain software revenue components, prompting an accounting restatement
 - Have not reported financial results since the 3rd quarter of 2012
 - Forced to delist from the NASDAQ



Market Cap (M):	\$265
EV/FCF:	8.8
Shares Outstanding (M):	38.9

The Opportunity Presents Itself

- Company's "in the dark" status, coupled with an auditor change and completion delay announcement, led to a 40% sell-off early this year
- The day before the delisting, the stock went from \$6.80 to \$4.93 for non-fundamental reasons
- Many funds cannot own a pink sheet stock, and so are forced to sell regardless of price



Source: Google Finance

The Road Less Traveled

- While most investors avoid companies that do not file their financial statements (which is why we follow them), a close look uncovered a potentially attractive situation
 - Business with high barriers to entry
 - Free cash flow positive
 - Secular tailwinds
 - Attractive valuation

We think this is an undervalued special situation opportunity

Avid Technology – The Business

- Business with high barriers to entry
 - AVID's high-quality video editing software is highly regarded and widely used by editing professionals
 - Was used in the editing of a number of famous films (such as the *Lord of the Rings*), as well as by most academy award nominees
 - The complexity of the software and large quantities of people involved in the editing process make switching costs high

In short, AVID is the dominant player in a very attractive niche

Putting the Pieces Together

- Investors have enough information from the 8-k filings to build a model despite not having current financials
- Free cash flow positive
 - Cash flow generation masked by costs associated with ongoing accounting restatement
 - Estimates based on management's comments imply a cost of around \$8-12 M per quarter
 - Company has also estimated that they've burned \$22-24 M in cash over the past year
 - Applying this burn rate to the annual restatement cost yields positive FCF

Provides compelling evidence underlying business has remained strong amid current turmoil

Buy Before the Cycle Begins

- Secular tailwinds
 - Arrival of 4k (Ultra HD) television sets should be the catalyst for the next cycle of television upgrades
 - Gets the name '4k' from its resolution, compared to the current 1080 standard
 - New standard for television will in turn create new standards for the quality of complementary industries such as AVID's

This dynamic should drive the next round of innovation within AVID's product line and require customers to upgrade to keep up with one another

4K – The Next Industry Cycle

- 4k Adoption
 - Prominent TV hardware providers are already starting to roll out 4k products
 - At this year's Consumer Electronics Show, nearly every major manufacturer announced a 4k display for imminent release
 - Alternative entertainment options are following suit
 - Netflix is shooting the next season of its hit show "House of Cards" in 4k



Cheap Valuation Metrics

- Attractive valuation metrics
 - 0.37x EV/Sales
 - 1.31x maintenance revenues
 - 0.64x EV/normalized gross margin
 - 10x EV/normalized free cash flow

Each is substantially below its set of comparable companies

Downside Protection

- What's it worth?
 - Substantial downside protection
 - Using a conservative 5% operating margin and 10x FCF multiple, we think the stock is worth at least \$7 per share (roughly the current price)

TTM Revenue	565
x Operating Margin	5%
<hr/>	
EBIT	28.3
-interest expense	1.0
-taxes	2.0
<hr/>	
Net Income	25.3
+D&A	30
-Capex	28
<hr/>	
Normalized FCF	27.4
÷ Shares Outstanding	39
<hr/>	
FCF per Share	0.70
x Multiple	10
<hr/>	
Value per Share	7.03

An industry leading software provider with 55-60% gross margins should easily be able to attain this operating margin in a normalized environment

Potential Upside

- However, peer companies have double-digit operating margins and we see no structural reason why AVID shouldn't have the same
 - If we assume it can achieve a 10% operating margin, shares would be worth nearly \$14
 - With revenue growth, Avid could earn over \$2/share
 - We again conservatively assume an FCF multiple of 10x

TTM Revenue	565
x Operating Margin	10%
<hr/>	
EBIT	56.5
-interest expense	1.5
-taxes	3.0
<hr/>	
Net Income	52.0
+D&A	30
-Capex	28
<hr/>	
Normalized FCF	54.6
÷ Shares Outstanding	39
<hr/>	
FCF per Share	1.40
x Multiple	10
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Value per Share	14.00

This implied AVID would be about a double from the current price of around ~\$6.80

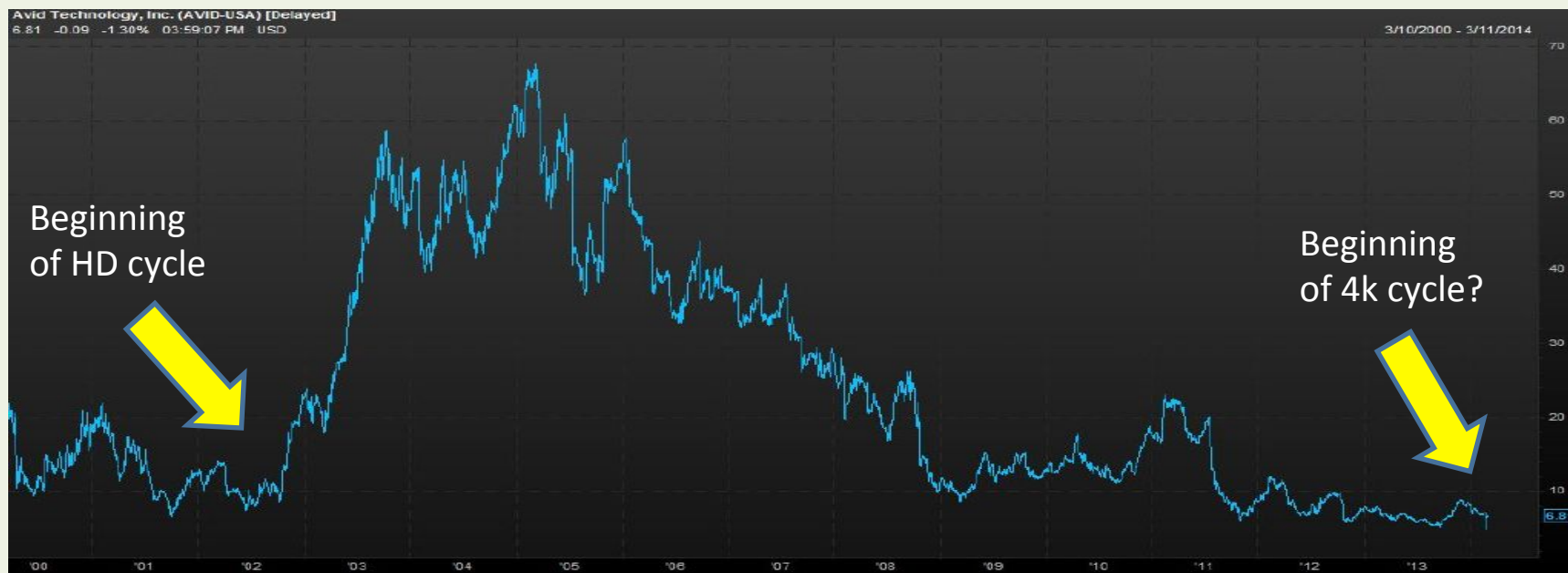
Buyout Candidate

- AVID's sustainable competitive advantages should also make it a potentially interesting target for an acquirer
 - The company instituted a rights offering in January that we think may have been in regards to a potential takeover offer
 - Belden is making acquisitions in the industry

“The Rights will not prevent a takeover of the Company. However, the Rights may cause substantial dilution to a person or group that acquires 15% or more of the Common Stock unless the Rights are first redeemed by the Board of Directors of the Company.”

History Often Repeats Itself

- A cyclical business, but buying during cycle upswings has historically been very profitable



The lack of financials has caused a position of maximum pessimism, but we think an inflection point is approaching soon

Thank You

Questions?