

Lumos Networks Corp.

NASDGS:LMOS

Analyst: David Itoafa

Sector: Telecommunication

Buy

Price Target: \$21.66

Key Statistics as of 10/28/2016

Market Price: \$14.06

Industry: Wired Telecommunication Services

Market Cap: \$328.03M

52-Week Range: \$10.18-\$14.70

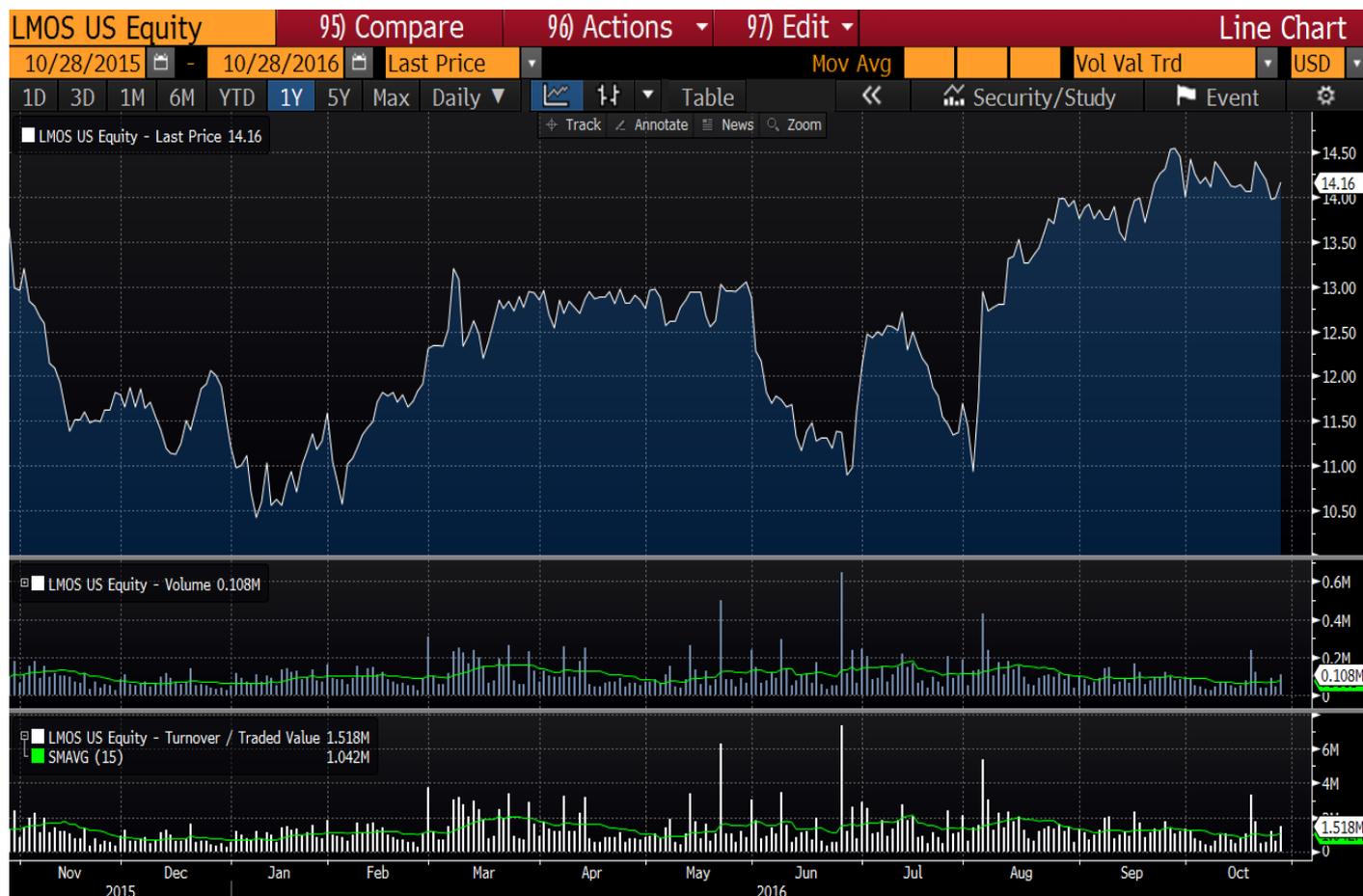
Beta: .77

Catalysts:

- Q3 Earning Call on November 9th
- 5G Network Fast Approaching

Company Description:

Lumos Networks Corp, is a fairly new fiber optic data, broadband, IP, and voice service provider. The company was founded in 2011 and as its headquarters in Waynesboro VA. Lumos operates solely in the U.S and conduct most of its business in the state of Virginia. The business has 3 main components: Data, Residential, and small business. The data component is the most significant and is where the Lumos generates the majority of its revenue, these are enterprise data, transport, and FTTC groups. Most of the company's enterprise clients are healthcare providers, state and local government agencies, financial institutions, and educational institutions with long lasting contracts ranging from 3 to 10 years. Most of the products offered on the Small Business and Residential side are voice products like local lines, long distance, primary rate interference, etc. Another essential component to Lumos is their rural local exchange carrier segment, which allows carrier customers access to switched access services.



Thesis

- Next earning call will beat analyst estimates due to consistent revenue growth.
- Once 5G network begins Lumos has more potential clients.
- Stock is completely undervalued by analysts for unjustified reasons.
- Business to consumer segment of business will increase due to customer first focused approach.

Timothy G. Blitz A CEO in Control

Analysts have undervalued Lumos because of the potential risks related to their operating expenses. As stated in the most recent earnings call the majority of the increase to operating expenses is of non-recurring expenses associated with market studies. Operating expenses incurred by 1.1 million this quarter will not happen again in the future. The money was mainly used for project clarity because Tim states that their intention is to maximize shareholder value. Analysts predict an increase in operating cost in relation revenue on the basis of the number and not the actual reason for increase last quarter. Analysts will be surprised with the results in the upcoming quarter and 2017. The biggest driver of the price is revenue, which also has major potential in the future.

Revenue Potential in The Future

Revenue growth has been a problem for Lumos since they were founded in 2011; however, over the past 5 years there is a major difference from year to year as seen below:

Revenue, Adj	206.9	207.5	201.5	204.3	206.1	208.8	215.0
Growth % YoY	-0.3	0.3	-2.9	1.4	1.7	2.2	3.0

The reason why revenue growth will explode is because most of their contracts range from 3 to 10 years. Since they are constantly signing new deals and their contracts are already so long there is room to revenue to keep growing. Moreover, they recently have had success resigning their fiber optic clients due a new way in which Lumos utilizes a network recycling program so that customers

continue to use their products after their contracts run out. This enables them to renew their contract for a similar price and not completely spike up the price like most of its competition. Another major player in future revenue growth is the expansion of the 5G network and the idea that more people in Virginia will switch to fiber optic network and phone in the future because they want the fastest possible network, which fiber optic providers offer. Another aspect worth noting is that they have a very low cost of revenue to revenue ratio.

	COR/Revenue	
	History	LFY
LMOS	20.0%	18.1%
Competitors	49.9%	47.5%

As seen in the graph, there are doing much better in terms of cost of revenue to revenue than their competitors. Their revenue has not been anything to outstanding up to date, and with future revenue growth they will be able to further push past their competitors.

Product Differentiation

The main way that their product differs from their competitors is the ability to connect with their customers. Companies like Verizon and Time Warner do conduct similar forms of business in different areas, but cannot have the same affect that a small company like Lumos does. Lumos only has a total of 593 employees and operates in only one country. Therefore, they have a small area to manage and do not get overwhelmed. They also customize each of their network experiences for each of their customers enabling them to create long lasting relationships so that when it is time to renew contracts with previous clients there are no issues. This is how Lumos differentiates its products from its competitors and continue to gain track in the state of Virginia.

Risks

One of the few potential problems with Lumos is that they do have a substantial amount of debt, which is making certain analysts skeptical. This is because they do not believe in their business model and future revenue growth. They have a high rate of default as seen below:

Lumos Networks Corp	
1) 1-Yr Default Risk	2) 1-Yr Default Prob
IG9	0.1997%

20% is very high, but is justified because they own 100% of their infrastructure. One very positive debt aspect of this company is the major reduction in short term debt and an increase in long term debt. Blitz has done a very good job of recovering from a very bad start of debt financing for their towers and other assets. They no longer need to use short term debt to finance their operating expenses. Which means, in the long run their cost of debt will decrease as they stabilize

Summary

Lumos has potential to take off in the long run for three main reasons. Blitz's ability to manage and direct the company in the correct direction is a major component that will propel Lumos upwards. Also, Operating expenses will not consistently decrease in the future. Revenue will continue to grow due to opening of new markets, the 5G network rapidly approaching, and most importantly their ability to create long lasting connections with big time customers. There are some risks associated with Lumos, but their positives outweigh the negatives. Lumos is well positioned to take advantage of the 5G network because it will increase the potential for future customers. Revenue is the main influence on the price of this company; therefore, when revenue growth spikes from the 5G network and all other aspects of their business, there is no stopping Lumos.

Lumos Networks Corp.

(LMOS)

Analysis by David Itsofs

10/27/2016

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Current Price:

\$14.16

Dividend Yield:

1.02

Intrinsic Value:

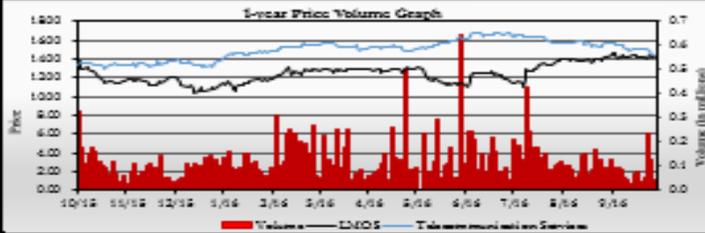
\$19.18

Target Price:

\$21.66

Target 1 year Return: 54.01%

Probability of Price Increase: 99.82%



Description:
Lumos Networks Corp., through its subsidiaries, provides fiber-based bandwidth infrastructure and services in the Mid-Atlantic region.

General Information:
Sector: Telecommunications Services
Industry: Diversified Telecommunications Services
Last Guidance: November 3, 2015
Next earnings date: November 3, 2016
Estimated Country Risk Premium: 7.88X
Effortful Tax rate: 48X
Effortful Operating Tax rate: 38X

Market Data

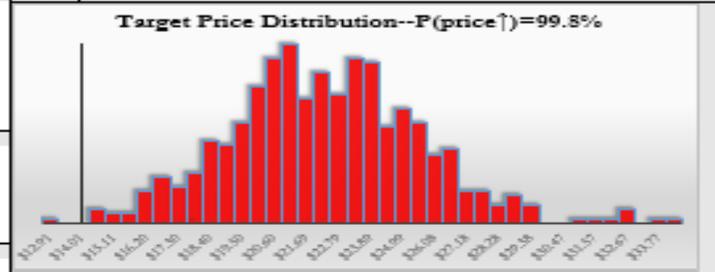
Market Capitalization	\$332.25
Dividend yield (mil)	8.11
Shares outstanding (mil)	23.46
Diluted shares outstanding (mil)	22.55
X shares held by institutions	85X
X shares held by institutional Managers	65X
X shares held by hedge funds	16X
X shares held by insiders	4.52X
Short interest	3.38X
Days to cover short interest	3.27
52-week high	\$14.71
52-week low	\$10.18
Levered Beta	1.14
Volatility	1.88X

Quarter ending

6/30/2015	Revenue	1.65X
3/30/2015	Revenue	-1.16X
12/31/2014	Revenue	1.16X
9/30/2014	Revenue	-2.63X
6/30/2014	Revenue	1.51X
Mean	Revenue	-0.23X
Standard error	Revenue	1.6X

EBITDA

6/30/2015	EBITDA	-18.48X
3/30/2015	EBITDA	-12.32X
12/31/2014	EBITDA	-4.78X
9/30/2014	EBITDA	-26.32X
6/30/2014	EBITDA	1.52X
Mean	EBITDA	-12.43X
Standard error	EBITDA	3.3X

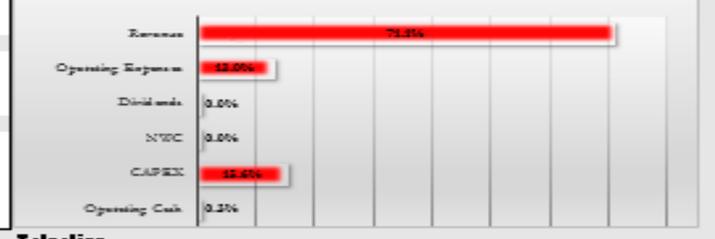


Management:
Dillo, Timothy
Prabhakara, Jagan
McDonnell, Mary
Miller, Jeffrey
Anderson, Diego
Ferry, Thomas

Total compensation grant

6/30/2015	Total compensation grant	-3.14X per annum over 3q
3/30/2015	Total compensation grant	-18.36X per annum over 3q
12/31/2014	Total compensation grant	-3.87X per annum over 3q
9/30/2014	Total compensation grant	-65.77X per annum over 3q
6/30/2014	Total compensation grant	-15.57X per annum over 3q
Mean	Total compensation grant	H/M

Sensitivity Attribution Analysis



Profitability

ROIC	4.5X
HOPAT Margin	15X
Revenue/Invested Capital	0.23
ROE	4.5X
Adjusted net margin	7X
Revenue/Adjusted Book Value	1.65

LMOS [5 years historical as an industry [LTM]

ROIC	11.82X
HOPAT Margin	27.11X
Revenue/Invested Capital	0.44
ROE	28.32X
Adjusted net margin	22.52X
Revenue/Adjusted Book Value	1.25

Capital Structure

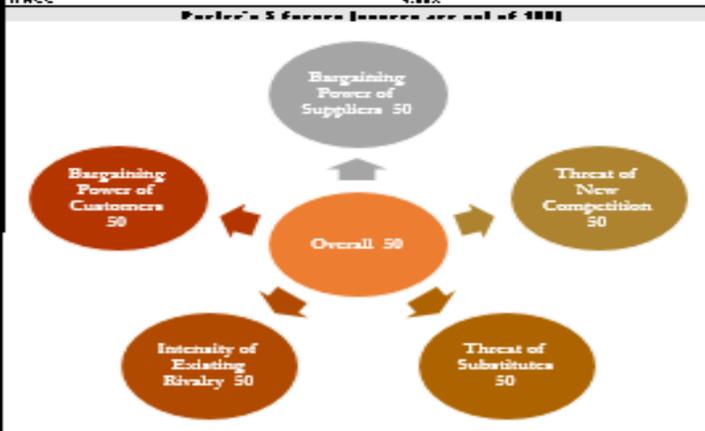
Total Debt/Current Equity [LTM]	1.71
Cost of Existing Debt	5.33X
Estimated Cost of new Borrowing	5.74X
CGPS Risk Rating	99
Unlevered Beta [LTM]	1.05
WACC	4.88X

LMOS [5 years historical as an industry [LTM]

Total Debt/Current Equity [LTM]	7.8X
Cost of Existing Debt	1.5X
Estimated Cost of new Borrowing	-1.1X
Invested Capital/Tot Capital	33.7X

Valuation

HOPAT margin	14.7X
ROIC/WACC	1.85
6/30/2017	7.3X
6/30/2018	5.8X
6/30/2019	12.2X
6/30/2020	14.1X
6/30/2021	15.1X
6/30/2022	16.1X
6/30/2023	17.1X
6/30/2024	18.1X
6/30/2025	19.1X
6/30/2026	20.1X
Confusing Period	21.1X



Period

Year Year	Revenue growth	1.7X
6/30/2017	Revenue growth	4.8X
6/30/2018	Revenue growth	4.8X
6/30/2019	Revenue growth	4.3X
6/30/2020	Revenue growth	4.8X
6/30/2021	Revenue growth	4.8X
6/30/2022	Revenue growth	4.8X
6/30/2023	Revenue growth	4.8X
6/30/2024	Revenue growth	4.8X
6/30/2025	Revenue growth	4.1X
6/30/2026	Revenue growth	4.1X
Confusing Period	Revenue growth	4.1X

Net Claims

Year Year	Net Claims	\$424.35
6/30/2017	Net Claims	\$355.48
6/30/2018	Net Claims	\$357.53
6/30/2019	Net Claims	\$318.45
6/30/2020	Net Claims	\$251.78
6/30/2021	Net Claims	\$187.48
6/30/2022	Net Claims	\$116.83
6/30/2023	Net Claims	\$33.28
6/30/2024	Net Claims	-\$45.65
6/30/2025	Net Claims	-\$133.14
6/30/2026	Net Claims	-\$248.82

Invested Capital

Year Year	Invested Capital	\$483.52
6/30/2017	Invested Capital	\$523.34
6/30/2018	Invested Capital	\$613.81
6/30/2019	Invested Capital	\$628.68
6/30/2020	Invested Capital	\$788.47
6/30/2021	Invested Capital	\$747.12
6/30/2022	Invested Capital	\$723.37
6/30/2023	Invested Capital	\$782.61
6/30/2024	Invested Capital	\$678.63
6/30/2025	Invested Capital	\$647.63
6/30/2026	Invested Capital	\$613.47
Confusing Period	Invested Capital	\$613.47

Price per share

6/30/2017	Price per share	\$18.88
6/30/2018	Price per share	\$21.51
6/30/2019	Price per share	\$24.62
6/30/2020	Price per share	\$27.84
6/30/2021	Price per share	\$31.15
6/30/2022	Price per share	\$34.51
6/30/2023	Price per share	\$37.31
6/30/2024	Price per share	\$41.35
6/30/2025	Price per share	\$44.81
6/30/2026	Price per share	\$48.27
Confusing Period	Price per share	\$51.63