

April 2007

## Here We Go Again?

News that private equity player Blackstone Group approached Intelsat's owners regarding a possible sale set the industry abuzz and led to more than a few people scratching their heads wondering what this latest move means. This is a fair question to ask of such a deal given that most people were looking towards an IPO for Intelsat and the expectation that at least some of the proceeds would go towards reducing the company's US\$11 billion debt load.

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What has most outsiders concerned is that the logic to a Blackstone Group purchase of Intelsat is unclear. The standard reply that private equity will come in and improve a weaker company's performance before selling the asset for a profit does not seem to fit. PanAmSat was arguably one of the tightest run fleet operators under Joe Wright's leadership prior to its sale to Intelsat, and most of the obvious efficiencies at Intelsat should be already obtained or the company is well on its way there. This leads many in the industry to speculate that Blackstone sees ways to pull even more cash out of Intelsat, most likely increasing the leverage on the company, before it in turn disposes of Intelsat in order to move on to greener pastures. Or, is there more to this development, and perhaps the deal will be done on behalf of another, perhaps non private equity party? For now, anything seems possible.

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The very capitalistic reply to these concerns is that this is a purely commercial deal. The private owners of Intelsat have every right to their profits, and it must be assumed Blackstone Group (or some other PE group) will not take on an asset like Intelsat unless they have some real, solid plans for the company. Those of us on the outside can twitter on all we want to about Intelsat's current owners reaping more than 10 times their initial investment, but as long as the new owners run Intelsat as a solid investment, there is no real reason this deal should not go through. Further, the industry as a whole is engaged in a period of sustained growth and, as implied by Intelsat's upper management, there does not seem to be any reason that the world's largest fleet operator should not take a nice large slice of this new demand.

There is also a new operational viewpoint which NSR has developed. This centers on Intelsat's focus on the offering of Managed Solutions - not quite managed services in the regular network service provider parlance, but something close. These are based operationally upon its GXS Network and GXS Media facilities. Here the newly expanded global reach of the full Intelsat plus PanAmSat satellite fleets gain substantial business traction from just a modest, but carefully crafted, terrestrial



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network architecture. For example, just the two Intelsat-owned teleports at Riverside, CA (US) and in Fuchsstadt (Germany) can uplink to satellites spanning all five continents; and so: (a) with some reinforcement then from either the Mountainside, MD or Ellenwood, GA, teleports in the U.S., and (b) the internetworking put in place on the ground between them all, which involves just four gateways into the terrestrial network, it is possible to transit from almost anywhere to anywhere on a global basis and in any format.

As a consequence then, Intelsat's customers can elect to utilize services that transit the network-at-large in a satellite-only mode, or (most commonly) operate via satellite plus fiber, or even fiber only (as opposed to simply leasing blocks of satellite transmission capacity). This Intelsat can pursue without, in NSR's view, any major head-to-head competition with its major capacity leasing customers. And already the group of solutions and services which Intelsat brands as GlobalConnex™ represent more than 10% of its business base.

Yet, there remain a number of valid concerns. First, Intelsat's business case appears to be built on everything going well for the company, including substantial growth in new customers and in premium revenues, from the Managed Solutions portfolio. And indeed the company will need solid growth in order to keep supporting its current (and possibly larger in the future) debt load. But just because the industry sees growth, and NSR is certainly one of those forecasting rising demand, it is very difficult to predict who will take what share of this growth. A simple look back a few months to the NSS-8 launch failure clearly illustrates that future growth of individual fleet operators can very quickly and very radically change because of unpredictable events.

Further, the view of strong growth for the industry is on an averaged basis, and there are definitely some areas of concern in a few of the biggest markets. Take for instance the C-band FSS market in North America, which is one of the largest and most profitable of the entire industry. The current industry mindset is that growing demand for HD content in North America is set to make even more money for the satellite operators, Intelsat included. Yet, what one often fails to hear mentioned is that to date HD growth has largely been offset by declines in analog broadcasting in North America. The combined Intelsat-PanAmSat entity alone saw 44 analog channels and feeds mainly in the North American market disappear from its fleets between the end of 2004 and the end of 2006. This is nearly equivalent to an entire standard satellite payload. Granted, much of this capacity was converted by clients to other uses including HD, but over the same time period the Intelsat-PanAmSat fleets have only increased the number of HD channels carried from 20 to 24. To be fair, the number of std. def. channels for the entire Intelsat-PanAmSat fleet went from 2,787 to 3,301 between the end of 2004 and 2006.

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If anything, the only outside party that has a valid concern to voice in the sales discussions surrounding Intelsat are its clients. These companies will be around long after Intelsat's current and next set of owners (assuming it is private equity) and whose businesses depend on the health and long-term strength of Intelsat. One might argue that many of these clients have long-term contracts with Intelsat so it is difficult for them to change fleets. Yet, as the example above regarding the migration of analog channels and feeds illustrates, it does not take many clients to decide that they are better off elsewhere when their contracts come to term for the future growth of Intelsat to be impacted. Never forget that it won't be beneath Intelsat's competitors to make the claim that long-term owners are better for a client than short-term cash focused private equity.

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The satellite industry we live and work in is part of the greater capitalistic market. Making money is a great motivator and drives continued improvement in our and all other industries. Yet, satellite fleet operators are in many ways infrastructure companies that sustain a whole spectrum of additional industries. It is incumbent upon any infrastructure company to remain sound and stable so that the clients that depend upon it will continue to make use of it. Should clients begin to lose confidence, they will go elsewhere as soon as it is permitted, and this could initiate a downward spiral. More clarity on any future owner's plans for Intelsat, be it Blackstone or someone else, would certainly be helpful at this point and may actually help increase the inherent value of the deal simply by reassuring their clients that Intelsat is, and will remain, a great and financially robust company.

By Christopher Baugh  
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Mr. Baugh founded NSR in 2000 to provide market research on domestic and international high-speed networks to vendors and carriers worldwide. Northern Sky Research (NSR) is an international market research and consulting firm specializing in telecommunications technology and applications. NSR primary areas of expertise include satellite and wireless networks, emerging technology, and media applications.