

The Smallsat Urge to Merge – Why now, and who's next?

As we detailed last month (see *Satellites going bigger or smaller?* Yes in the October 2008 issue of *From the Ground Up*), the market for satellite systems is broadening, leading to growth in demand for large as well as smaller satellites. While the trend for increasing power levels for commercial satellites (a direct driver of their size) towards and beyond 20 kW has been around for some time, the expansion of demand for smaller satellites is a relatively new phenomenon. At the same time, this expansion of demand for small satellites has been mirrored by an expansion of demand for small satellite *companies*. Consider the following transactions:

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| Target | Acquirer | Year |
|-----------------------|---------------------|-----------------------|
| Spectrum Astro | General Dynamics | July '04 |
| Swales Aerospace | ATK | June '07 |
| AeroAstro | Radyne | Aug. '07 |
| Alliance Spacesystems | MacDonald Dettwiler | Dec. '07 |
| Microsat | Sierra Nevada | Jan. '08 |
| Surrey Satellite | EADS | April '08 (announced) |
| SpaceDev | Sierra Nevada | Oct. '08 (announced) |

Quite apparently, capital has been chasing the small satellite industry. But why?

One reason is the expanding capabilities (and thus the expanding market) of small satellites – as detailed last month. With the market for larger space systems growing more slowly, smallsats offer a way for these larger firms to reignite their growth, and thus investor interest.

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So, while part of the reason is clearly the growth in the market for the product and technical capabilities of the companies themselves, we think another force is also at work here. The answer lies in looking at the acquirers – typically large companies that have other space systems capabilities – but have few or no small satellite offerings. While this could be thought of the classical build vs. buy scenario, where buying is cheaper, we think that is too simple as well.



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Rather, we note that most of these small satellite firms are not only focused on a developing market niche, but are developing companies *themselves* – that is they are young firms. As important as their technical capabilities are, we think their “start up” cultures, where costs are very closely monitored and controlled by necessity, are also attractive to acquirers. To some extent this mimics the situation at SpaceX, where the same sort of culture has resulted in drastically lower costs. The key, of course, will be to see the extent that these firms can remain entrepreneurial as they are incorporated into their larger parents. From the perspective of these parents, when considering entering the sector one needs to have this cultural advantage to compete – but it is virtually impossible to create from scratch. So, acquisition becomes the only real way for them to address this growing market opportunity.

Of course, from our perspective as bankers to the sector, the question arises: what next? If past experience is any guide, we expect this trend to continue. With ten or so remaining smallsat companies out there, and today’s market conditions that make it difficult to fund smaller private companies, we think the trend will not just continue, but accelerate. As for who is next, we expect that firms will largely choose to merge based on their ability to book orders (which will drive values up) vs. their ability to access capital (which may force them to sell out as their resources are exhausted).

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