

Markets put geography on the map

If you're on the lookout for 'green shoots', economic or otherwise, it helps to have a bird's eye view of the globe to find it. As luck would have it, on May 14th, 2009, we got both a green shoot in the financial markets and a bird's eye in the sky. DigitalGlobe, the Colorado-based operator of imaging satellites and geospatial analysis solutions made its entry to the public markets with the fifth IPO of the year. From the financial markets' point of view, it was yet another step towards re-establishing a normal IPO market. From the satellite imaging sector's point of view, (indeed, for the entire geospatial industry), it is yet another sign that, where the financial markets are concerned, they've arrived.

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For public companies no less than individuals, one is too often the loneliest number – all the more so the case with DigitalGlobe's rival, Virginia-based GeoEye Inc. GeoEye has been public now almost three years and yet seemed like an orphan, the only traded commercial imaging satellite shop on the block. With two publicly traded competitors now, we can make comparisons. Both companies operate a set of high and medium resolution satellites, both are heavy clients of the US government (particularly the NGA), and both will have roughly the same revenues once GeoEye's GeoEye-1 is fully operational. Even though both have their significant differences, they are at the time of this article's writing both trading with an enterprise value at 3.6 times revenues and both at a PE ratio of around 15, decently bullish.

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Comparisons aside, the real question for both companies is, as usual, what next? What are their eventual fates? Improving technology and greater demand for more detailed imagery and geospatial analysis will keep a going arms race of ever more powerful imaging satellites for some time – though only within limits that the US government (a customer of 70-80% of both GeoEye's and DigitalGlobe's revenues) allows. Moreover, neither is likely to overpower or acquire the other in the foreseeable future, (a la Sirius and XM in satellite radio), if only because it continues to be the US government's interest to maintain the balance of power between two competing viable commercial imagery sources. Acquiring another rival isn't likely in the cards either. While the rest of the commercial satellite imagery field is highly fragmented in both capability and scale, (operators Spot Image, ImageSat and

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RapidEye compete on low and medium resolution, while MDA Geospatial and infoterra offer radar sensing), almost all of these companies have a government participation that, similarly, makes acquisitions difficult. One needn't look farther than ATK's thwarted acquisition of MDA Geospatial for a case study of a government (in this instance Canadian) protecting its satellite imaging crown jewels. Cooperation is likely the way to go for the time being, with larger operators adding to capabilities in overlooked areas, such as ubiquitous low-resolution coverage as well as continue to develop capabilities in aerial photography and intelligence.

Even as many barriers to entry persist, (i.e., high capital costs, government participation), the product (imagery) becomes more and more commoditized on the commercial end of the business. In addition to pictures from orbit we have pictures from aerial vehicles, floating balloons and dirigibles, travelling cars with street view cameras, as well as crowd-sourced data from millions of clicker-happy tourists. We haven't gotten to the point of real-time high resolution video of the Earth, and are likely still a ways from it, but already the gushes of data is making raw imagery less than scarce for most non-government purposes. As the product becomes less valuable, margins inevitably get squeezed. When that happens, where does the money get made? Just as the telecom satellite industry offers network and systems integration services to augment its transponder leasing business, imaging satellite operators offer geospatial processing, manipulation and interpretation services. In theory, this sounds like a recipe for vertical integration into high value services. In practice, much as in telecom, value-added services are often engineering and manpower heavy, while margin light.

Even if the imagery business continues to avoid commoditization through innovation, it is unclear where, ultimately, the pivot of this industry lies. Both GeoEye and DigitalGlobe are decently sized firms, and bound to get larger, but for all intents and purposes, these are small cap companies. In scale and in commercial significance, they are overshadowed by the major players in GPS devices, such as Garmin, TomTom and Trimble, as well as by ESRI, one of the largest players in the GIS/Geospatial software. Certainly, even these are tiny compared to two of the most significant commercial customers, Microsoft and Google. Telematics, asset tracking, land management, and geospatial analysis are believed by many to be growth industries: any one of the large players, or others, may feel that the market needs a true



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end-to-end solution and proceed to roll up manufacturers, developers and service providers across the value chain, including the imagery providers.

If it makes sense. Although many companies may feel that they'd best stay out of the business of operating satellites, the idea that someone might seek to take control of a strategically important source of data (geographic or otherwise) is not out of the question, so long as it does not trample over national security concerns. The acquisition of NAVTEQ by Nokia and of TeleAtlas by TomTom vividly illustrated the extent that the GPS OEMs would go to assure access to the two primary repositories of digital road data. Could satellite imaging companies be subject to bidding wars on imagery assets just as the roadmap companies were? Perhaps. Then again, NAVTEQ and TeleAtlas's advantages were the millions of man-years put into painstakingly mapping, cataloging and updating every automobile-accessible crevice of western civilization. When up against that barrier to entry, the cost, effort and time to build, launch and operate a satellite almost seems like child's play.

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"*HC SVNT DRACONES*", or "Here be dragons" reads a famous 16th century globe, now on display in the New York Public Library. A pity that DigitalGlobe or any of its competitors were not around at the time – if so, they might well have captured beautiful high-resolution images of those dragons, bathing and sunning themselves in the tropical Pacific. The dragons of today are likely far less photogenic and might look more like widening credit spreads, toxic asset-backed securities, bank failures and other hazards of the financial world. Not to mention the dragons of government involvement, limited M&A and the risk of commoditization. Regardless of future direction, with a successful IPO under its belt and room for growth, DigitalGlobe has shown that even though it can't exactly photograph these dragons, it can certainly shoot them down. Most would agree: those would be a sort of green shoots worth cheering for.

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