



Is MHR preparing for an exit from Loral?

With Space Systems Loral's recent IPO filing, here at Near Earth we decided to look at that pending transaction from a more strategic perspective, and particularly in light of SS/L's relationship with its parent Loral Space and Communications. But first, let's consider the relevant background – starting with the details of the IPO itself. While terms have yet to be announced, the filing identifies an intended size of up to \$100 million, including over-allotments, with all proceeds from the sale of shares going to the company for general purposes.

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Operationally, SS/L has done very well the last few years – becoming the largest commercial manufacturer of satellites in the United States, growing its revenues from \$814 million in 2007 to over \$1 billion in 2009. But this growth has come at the price of an increasing need for capital, forcing the company to dip into its \$100 million credit line periodically. While the company had just over \$100 million in cash at the end of Q1/2010, the potential proceeds from the IPO would significantly liquefy the firm and enhance its competitive posture.

Depending on terms, the offering will dilute their 100% ownership but still leave SS/L's parent Loral in control with over 80% ownership – implying an intended pre-money target valuation for SS/L in the ballpark of approximately \$800+ million. For a growing firm with over \$1 billion in sales, \$1.6 billion in backlog and a strong market presence and technology base, this valuation looks reasonable.

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Taken in greater context, the offering helps the overall liquidity of Loral the parent by essentially eliminating any potential need for SS/L to call upon it for capital – which given the highly levered nature of Loral's other investments (principally Telesat) does provide some comfort. More importantly, however, it opens the door for Loral to consider divesting itself of SS/L entirely. This is because by establishing a public market for the shares, and garnering research coverage and trading volume, Loral's remaining 80% stake becomes more liquid, and could be offered to the public through a secondary. By placing a concrete value on that 80% stake it retains, Loral also helps put a value on itself – with any luck a higher value.

So if Loral is getting all dolled up for the prom, does that mean other plans are afoot? Perhaps – look at the five year chart below and consider that Loral’s stock chart represents an impressive comeback following a “near death” experience and subsequent recovery. (As an aside, the company never actually had any existential operational or liquidity issues, but the market reflects perceptions about the future, which ran wild during the period where anything with high leverage was assumed to be doomed) Certainly the round trip in valuation has some bearing on the position of the folks at MHR that effectively control Loral and have a 59% economic ownership stake.



What other factors could be driving MHR’s thinking with respect to Loral itself?

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Starting with SS/L, we note that after years of losses, it appears to have found the path to profit. While the sustainability of those profits remains to be demonstrated, the effect they have on valuation today is indisputable, and may make today a good time to consider a transaction at the parent level as well.

It certainly doesn’t hurt that valuations in the fixed satellite sector are near an all time high. In addition to Loral’s appreciation as evidenced in the chart above, Loral’s competitors SES, Inmarsat and Eutelsat are all trading at or near their highs as well.



While the debt markets are far from fully healed, credit is more available than at any time since the market meltdown, and interest rates (at least in dollars) remain near all time lows. Given Telesat's heavy debt load, a buyer may need to inject significant amounts of equity to acquire Telesat if much of the debt can not be refinanced. No problem: Echostar has nearly a billion in cash on hand, and Eutelsat with leverage of only 3x EBITDA is also well positioned. There are also cash rich firms outside the satellite industry that are likely to find the steady cash flows, global marketing footprints and technical savvy of Telesat to be attractive.

In addition to having the means, Echostar, Eutelsat and others also have the motivation to pull off a Telesat acquisition. Both of these regional players need a global footprint that Telesat helps to provide, especially for Eutelsat with which it has little overlap. And, Echostar needs additional scale and access to Loral's selling apparatus.

Perhaps most importantly, in the Speech from the Throne delivered on March 3rd, Canada's Conservative government raised expectations by revealing the federal government's intention to "open Canada's doors further to venture capital and to foreign investment in key sectors, including the satellite and telecommunications industries, giving Canadian firms access to the funds and expertise they need." They could as easily have said "giving American hedge funds access to more potential exits, especially to strategic investors like Eutelsat and Echostar". The exact timing and nature of this access remains to be demonstrated, however, and governments do change their minds or fail to act.

So in conclusion, while we believe that SS/L's IPO makes good sense in Palo Alto, we think the real drivers for the transaction lie in New York. There are still a lot of moving parts, but the end game is becoming a bit more apparent. Is MHR really headed towards the exit? We don't know. What we do know is that, for the moment, the stars are lining up so that if they *want* to, the exit will be there.

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SPECIALISTS IN SATELLITE, TELECOM AND AEROSPACE INVESTMENT BANKING

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