PROFILE Dara Panahy

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Capitalizing Space

From an investment standpoint, the satellite industry has recovered nicely from the telecom bust a decade ago, when several high-profile failures, among them mobile service providers Iridium and Globalstar, cast a pall on the entire sector. The major fixed satellite services operators are highly profitable and regarded as safe havens these days, while the reconstituted Iridium and Globalstar are building second-generation constellations.

But the nature of financing has changed. Equity financing in the form of initial public offerings has all but dried up in recent years and debt is king, backed in many cases by export credit agencies (ECAs) such as France's Coface and the U.S. Export-Import Bank.

Critics say ECAs have been distorting the market by enabling projects of questionable viability to move forward. But Dara Panahy, whose law firm specializes in satellite project financing, says ECAs are only filling the void left by the departure of equity and high-yield debt financing, which are generally available under normal market conditions.

While it is the role of ECAs to promote exports by a nation's industry, Panahy says they have to do their due diligence just like any commercial bank.

Panahy spoke recently with *Space News* Editor Warren Ferster.

How would you characterize the current satellite financing environment?

I'd say it's choppy. The current market really focuses on quality of the borrower. Companies such as DirecTV, EchoStar, SES and Eutelsat, given their strong balance sheets, generally have no problems obtaining debt in this market. Companies with weaker balance sheets or which are more speculative have to resort to either ECA backing or project financing. In some cases, financing may not be available.

Project financing?

Project financing is financing that's based not on a company's balance sheet but rather on expected revenue of the project going forward. A good example is O3b. It's a bet on the future revenue of the project.

What about Iridium?

Iridium was purchased in a SPAC — or special purpose acquisition company — transaction, also known as a reverse merger. That's another way to move equity into a company, which is to finance it based not on the balance sheet of the target but on the credit enhancement provided by the buyout firm. One of the two parties had to have a strong balance sheet. In this case it came from the investment firm.

How do satellite projects stack up against other telecom ventures in the eyes of the financial markets?

Based on the deals that we have visibility into, satellite continues to do better than your traditional telecom and media markets and that's because of stability. If you look at fixed satellite services, mobile satellite services and remote sensing, on an average basis these companies are still growing — revenue is growing, backlog looks strong, capital expenditures are well contained within annual revenue cycles. Compared with the rest of the telecom media market where you're seeing some failures, it's considered to be a safer haven.

Is ECA financing distorting the satellite market?

I don't think it's distorting the market; I think it is serving as a replacement for what would traditionally be a capital markets activity. If you look at the two lead export credit agencies, Coface of France and the U.S. Export-Import Bank, they run the same credit analysis as any bank would, and in the case of a loan guarantee, the participating banks also have to accept that the project is one that they would otherwise lend against.

Aren't ECAs enabling projects that the rational market has rejected?

The credit analysis for an Iridium or an O3b is the same as it would have been had it been done by merchant or commercial banks. The rates might be a bit more favorable but it's the same risk analysis. Some will argue that the threshold might be a little lower because there's a sovereign consideration — Ex-Im and Coface want to support the export market, create jobs in their countries. So perhaps there might be a slight — and I mean very slight — relaxation of standards, but I don't think it's correct to say that ECAs are making capital available to companies that otherwise had no chance of getting it.

There are covenants under these loan facilities that are primarily finance and revenue based. Sometimes they're subscriber based. So if a borrower has a significant trip up, lenders have the ability to re-evaluate the loan, either to modify it or cut it off. These loans are not one big check issued at inception; they're based on established project expenses. For example, with Globalstar and Iridium the loans are actually disbursed based on the milestone payment plans under the construction contracts, the launch services agreements, etc.

But since the bulk of the money is spent on system deployment, which for new projects obviously precedes execution of the business plan, how can lenders really protect their investment?

Nobody has a crystal ball to actually bear out whether or not business models were sensible, whether subscriber projections were rational, whether the market would emerge as expected. In any satellite market — whether you look at mobile, maritime or aeronautical — there's going to be speculation.

If one or more ECA-backed satellite projects fail, won't that scare investors away from the satellite industry in general as happened a decade ago?

A few things have happened since the failure of the first-generation Iridium and Globalstar. The investor market has become a lot more sophisticated. There is differentiation between fixed and mobile satellite services. There's differentiation between direct to home, point to point, point to multipoint and cable head-end distribution. The analysts, the investors and the banks know these markets and can differentiate between one that is failing and one that is succeeding. So I would say, as a general proposition, no, unless you have a cataclysmic event that affects the entire satellite services market.

What is the biggest lesson from the satellite telecom collapse of the early 2000s?

It's having the discipline to balance the opportunity of technical innovation — a first mover advantage, a new product or area that is promising — with the old-guard, established financial metrics of credit risk and potential rate of return. Where we've seen markets get distorted, where we've seen spectacular failures, it's been primarily because either the market studies or expectations were completely wrong — they just grossly exaggerated a market — or there was such a focus on the technical wizardry and innovation that investors lost sight of the fundamentals.

Have you noticed an uptick in merger and acquisition activity as defense spending tapers off?

There's a trend toward diversification. With space companies that are primarily involved in serving governments, we're seeing deals that will diversify revenue. You're seeing Astrium get into services by buying Vizada or ND Satcom; companies like Boeing are entering into creative transactions where they're actually buying a certain amount of the capacity of the satellites they're building — for example, Inmarsat's Global Xpress — because they see a market in value-added communications services for not necessarily just the Defense Department but also potential civil and commercial customers. Years ago the key manufacturers were running away from having any services businesses.

A number of companies hope to develop systems to ferry crews to the international space station and back. How do the markets view this as an investment proposition?

Man-rated space has always been viewed by the commercial market as the province of space agencies. The thresholds for error, for the potential loss of life, are very, very thin. The banks generally don't like to get involved in ventures where you have a not-insignificant risk of bad headlines, disasters, etc. I wouldn't say there is zero appetite, but there has to be significant progress before you're going to get private financing to back that up — and by private financing I mean banks, hedge funds. I don't mean your individual investors.

What about a company like Space Exploration Technologies (SpaceX), which has a $1.6 billion NASA contract to fly cargo to the space station?

SpaceX is betting that the anchor tenancy of NASA, with its commercial business — based on their public manifest it's about 50 percent of their business — will be very attractive to investors once they can prove they can safely take cargo and then astronauts to the space station. If they can pull that off, it becomes a very attractive play because you've got a company that's truly diversified.

LightSquared invested some $3 billion in a mobile broadband service only to hit a potential showstopper in the form of GPS interference. What happened?

You're seeing the convergence of an opportunity to reallocate mobile satellite spectrum, a Federal Communications Commission that's trying make that happen and then an inevitable situation — not just in the mobile satellite services space — where you're going to have more and more interference issues because we're running out of spectrum. In the past we had the luxury of guard bands, of low power levels and gaps between different services. That luxury is eroding.