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Knocked out of orbit

In its latest short campaign, Kerrisdale Capital claims satellite internet provider ViaSat is doomed to fail due to pressure from broadband and wireless competitors, but investors and analysts insist the short seller ignores some key aspects.

As ViaSat's CEO Mark Dankberg and his underlings were jubilantly celebrating with Hawaiian music and teriyaki chicken the successful launch of the company's second-ever satellite into space, an activist short seller was preparing to spoil their party. Sahn Adrangi's **Kerrisdale Capital** erupted with a negative campaign in its habitual style just two weeks after Viasat-2's take-off. A disparaging and at times sarcastic 56-page report was followed by a website and lengthy conference call. Although Kerrisdale is not the first activist to attack ViaSat – **Lakewood Capital** shorted the stock in October 2016 – it certainly is the most energetic.

Stronger Rivals

In mid-June, Kerrisdale said with great conviction that ViaSat had at least 50% downside because its consumer business – accounting for 34% of revenues and 70% of Ebitda – will be decimated by traditional terrestrial operators and wireless providers as they steadily step into its turf with vastly superior solutions. ViaSat's residential offering, which caters to remote rural

ViaSat

Industry	Communication equipment
Sector	Technology
HQ	Carlsbad, California
Market cap	USD 3.56B* * as of September 5, 2017
Exchange	NASDAQ
Ticker	VSAT

areas, delivers limited capacity of up to 30 GB per month for \$150, while its cable and DSL competitors dispense unlimited data plans for a third of the price.

Aggrieved satellite customers leave the minute they find a better alternative, leading to high client turnover, according to Kerrisdale. To counter lost revenue from customer losses, the short seller says ViaSat has resorted to “classic telecom gimmicks” of selling non-core products to inflate its average revenue per user (ARPU). But “jamming” customers with “commoditized add-ons” like VoIP and antivirus is not a viable long-term strategy and the capital-intensive ViaSat is set to crumble, it adds.

Killer combo

Aware of Wall Street's love for the stock, Kerrisdale was prepared for the skeptical voices that started to cry foul almost immediately. B. Riley analyst Mike Crawford swiftly proclaimed the dip caused by the short report as a 'buy' opportunity. Crawford eagerly pointed out that ViaSat's government

business, making up 44% of the revenues, is a “killer combo” with an ability to deliver bandwidth in the hardest to reach locations.

Cove Street Capital, a large ViaSat shareholder and occasional activist investor, took it to heart, vigorously defending ViaSat and deriding Kerrisdale's report as “another 56-page pile of crap.” Amidst accusations of bad math and poor fact-checking, Cove Street notes in its scornful 10-page rebuttal that Kerrisdale completely ignores the “defense business with a \$633 million backlog worth 53%” of the stock's value. The add-ons make a smaller part of revenues than Kerrisdale claims and the ARPU is considerably higher, Cove Street, which declined to comment for this story, argues.

Flawed thinking

Speaking with *Activist Insight Monthly*, Kerrisdale Chief Investment Officer Sahn Adrangi maintains that valuing the defense business separately from consumer and aviation is flawed. Although Adrangi admits that defense

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is viable as a standalone unit, he argues it subsidizes the rest of the units, which will never be cash-flow positive. “It’s like a biotech, they’ve got one drug in the market that’s generating cash flow but that drug’s cash flow is being used to reinvest in R&D for another drug that will fail,” Adrangi says. “And that really takes value away from your original drug.”

Adrangi was unmoved by Cove’s report. He says the diatribe “barely addresses” one fundamental issue: that the best long-term internet solution is wireless, not satellite. “Ultimately you’re just going to get to a point where satellite is not going to be able to compete with wireless,” he reckons.

Vindication

On August 9, ViaSat tumbled more than 10% following an earnings miss which vindicated Kerrisdale. Both revenues and earnings per share came in lower than expected, while net subscribers

dropped by 34,000, lending credence to the activist’s thesis. The results prompted **Wells Fargo** analyst Andrew Spinola to concede that “broadband markets don’t stand still,” although he did not change his “outperform” recommendation.

The company’s government business saw orders surge by 25%. ARPU growth, meanwhile, was up 11%, as the company improved focus on the high-end market. Spinola blamed the poor numbers on the delay of Viasat-2, which cost \$624 million to build and will enter service in early 2018.

Constant change

Adrangi’s appetite for shorting telecom equipment companies has increased in the past two years, despite mixed performance. A short position in **Straight Path Communications** was blown out by a bidding war between Verizon and AT&T earlier this year, while a campaign at **Dish Network** has yet to produce results.

Kerrisdale has not been the only wolf hunting for prey in telecoms. According to *Activist Insight Online*, 2017 has seen seven short campaigns so far in the sector, including two at Straight Path. In the whole of 2016, nine short campaigns were launched, while 2015 was a blockbuster year, with 14 campaigns started. Adam Gefvert, head of research at short selling outfit **White Diamond**, believes telecom has lured short sellers because the technology is “largely unproven,” with the entry date of 5G a matter of speculation. “It’s easy for people to be skeptical about how soon [5G] will arrive,” Gefvert tells *Activist Insight Monthly*.

Adrangi, meanwhile, says the sector’s pace of change is its most charming attribute. “You typically won’t see short activists publish as much on a consumers’ staples company making laundry detergents... because those industries aren’t changing that much, whereas in tech and telecom there is constant change.” 📉

ViaSat 12-month share price performance





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