

Intelsat S.A.

Recent Price Weakness Provides Attractive Entry Point As FCC Proceeding Gains Momentum

Since our [last article](#) on Intelsat, newsflow has continued to trend positively and point to major positive catalysts over the course of 2018, yet Intelsat shares have tumbled from the mid \$20s to the mid teens. In this article, we provide updates to our thesis and timeline; for background, please also see our original [report](#) and 2018 [update](#).

Commissioner Support

The Federal Communications Commission oversees spectrum policy, so it's important to understand the thinking of current FCC commissioners. Spectrum policy is a complex, esoteric subject and Congress and other political participants tend to not meddle with the FCC's policy goals. The FCC, a 5-person commission, is typically governed by 3 commissioners from one party, and currently it's the three Republican commissioners of Ajit Pai, Michael O'Rielly and Brendan Carr who direct FCC policy. So to get a sense of how the C band reallocation will occur, simply listen to what the Republican commissioners are saying.

On April 4, Commissioner O'Rielly spoke about the C band proceeding in a [speech](#):

While placing 3.5 GHz into the hands of industry is a huge step forward, it is just not enough spectrum, by itself, to support 5G. The Commission must move with all due haste to conclude its proceeding to open the C-block spectrum for additional wireless use. The existing C-Band satellite downlink spectrum – or 3.7 to 4.2 GHz band – provides the best mid-band spectrum play for 5G wireless services. Not only is it the largest swath of mid-band spectrum available, but it is adjacent to the 3.5 GHz band and the current satellite licensees are willing to part with some of it. I have led the charge to open this band for terrestrial use, and it remains one of my highest priorities for this year at the Commission.

As many of you have heard me say, the question is no longer whether there will be wireless operations in the C-band, but what is the appropriate mechanism for reallocation and determining how quickly it can occur. When the Commission started this proceeding, I announced some very simple principles that would need to be met. Besides accommodating the current incumbent users, the plan needs to repurpose a

sufficient amount of spectrum – at least 200 to 300 megahertz – for private sector wireless use and has to happen quickly. How quickly? Yesterday would have been nice, but, under no circumstances, can the Commission adopt a process that takes five or more years to get this spectrum into the marketplace. Indeed, the Commission needs to come to a resolution and adopt an order in the coming months to ensure that we keep pace with the global community in the mid bands.

O’Rielly says that the commission **needs** to adopt an order **in the coming months**. If Pai agrees, it will happen. Spectrum policy, at least in the vast majority of instances, is not decided by Congress, or the courts, or by any other chamber of the government – it’s determined by the FCC, and commissioners continue to indicate that they favor the C-Band Alliance’s market-based proposal, an order may be enacted in the coming months, and the SatCo’s keeping all of the proceeds is not a concern.

Sellside Summary

It’s been heartening to see sellside analysts almost unanimously highlight Intelsat as undervalued during the recent price drawdown.

Most recently, JP Morgan’s Phil Cusick, who has long had a neutral rating, upgraded the stock (4/3/19, “Intelsat: C-Band Spectrum Sale Still Most Likely Course; Upgrade Intelsat to Overweight”) with a \$27 price target, noting:

“We believe that after being overly-optimistic in the fall, the market is now underpricing the likelihood of Intelsat and the CBA’s eventually selling spectrum and reaping substantial proceeds. We believe that the CBA still has the support of key decision makers at the FCC and that some version of a market-based approach is the most likely path to get C-Band spectrum into the hands of wireless carriers in the next 5 years.”

JPM assumes 180Mhz gets sold, at \$.25/MHz/pop, with Intelsat keeping 45% of proceeds -- that gets them a \$27 price target. (We think, ultimately, more than 180Mhz gets sold and the price is \$.50/MHz/pop or higher.) JP Morgan adds:

“Intelsat shares at \$15 only price in about \$10 billion of total auction proceeds (\$0.175/MHz-pop for 180 MHz, \$1.75b clearing, ~\$4b for Intelsat), which we don’t think is ridiculous even were only Verizon to take it all. Our base case remains ~\$15b (or \$0.25/MHz-pop) and we believe risk-reward **skews to the upside from here.**”
[Emphasis added]

As for timing, JPM writes:

“From here we expect the CBA to work toward placating some of the opponents of the deal to try to ease the path to approval. The FCC could then issue its approval of the

CBA plan, likely with some modifications, as early as mid-year (but probably later), and a privately run auction with FCC oversight could happen late this year or in early 2020.”

Another former bear, Morgan Stanley, has similarly come around and maintains a price target 50% above the current price (3/18/19, “Intelsat: C-Band Process Maintains Pace, But Secular Pressures Impacting Fundamentals”), writing that “though recent news has resulted in volatility to the low public float stock, the C-band monetization story remains on track for a midyear final report and order from the FCC.”

The most informative recent report is the highly bullish initiation from Evercore in February (2/25/19, “A Spectrum Kingmaker? Initiate Coverage With Outperform, \$50 PT”), where Evercore explores virtually every facet of the story in its 42-page initiation report. Evercore also offers particularly helpful scenario analyses in its report, that allow readers to determine different price targets that would result based on different assumptions around MHz released, price per MHz/Pop, clearing costs, percentages of proceeds that are diverted to treasury, etc.

Additionally, Cowen and Jefferies also have published optimistic views of an FCC order and private sale/auction in the near term, with \$50 and \$36 price targets respectively.

Will CBA Be Able to Keep the Proceeds?

Based on the comments section of our most recent article, discussions with short sellers, and the events that have triggered the sharpest 1-day declines in the stock price this year, a key concern among skeptics is whether the CBA will be able to keep all the spectrum proceeds.

It should be obvious that the opinions of a handful of congressmen and senators do not represent the majority opinion of the Congress and Senate, nor will an introduced bill easily translate into actual legislation. We think that in both the House of Representatives and the Senate, the majority of elected officials would, if pressed to an informed vote, overwhelmingly back the FCC commissioners on this issue, simply because the CBA proposal is in the national interest. Spectrum in 50Mhz-100Mhz blocks in 3GHz is forming the backbone of 5G all over the world, because it can be enabled for Time Division Duplex (TDD) and the larger block sizes are a better fit for 5G, allowing carriers to take advantage of massive MIMO to reduce latency and increase speeds. The United States, unfortunately, cannot make other frequencies in 3GHz available for effective 5G use, because its frequencies from 3550 MHz to 3700 MHz are encumbered by the CBRS proceeding, which will place power limits on spectrum usage, divide the frequencies into small regional blocks, and force users to employ a sharing mechanism for the spectrum. Given that other countries have been auctioning off their 3GHz frequencies to their carriers over the past 2 years, the United States has fallen behind. The C band is the nation’s last hope for providing its carriers a comparable 5G backbone to other countries, and given that the U.S. is already trailing, timing is paramount. That’s why, if put to a vote, politicians across both sides of the aisle will back the FCC in supporting a market-based transaction – because it’s the fastest way of getting the C band into the hands of the carriers. Generating

proceeds for the Treasury is not as important a priority; after all, the federal government generates annual revenue of \$3.6 trillion each year, and it doesn't need FCC spectrum proceeds to conduct business.

Yet any proposed legislation is extremely unlikely to ever get to a vote, or make much progress at all. How long would it take to draft a bill in either the House or Senate? How long for mark-ups? How long to get it through committee? A few weeks ago, the Airwaves Act was indefinitely and perhaps "permanently" delayed. New Street Research wrote: "The legislation was meant to address a wide variety of topics related to spectrum, 5G, and rural buildout, but one of the key provisions would reportedly call for an FCC auction, not a CBA-run auction or sale, of the C band. We always thought the legislation would face a difficult passage, but whether it passed or not it would provide a signal of Congress's preference to the FCC. Absent a signal from Congress to the contrary, it is easier for the FCC to justify a CBA-run process."

While a Congressional action requiring the CBA to remit part or all of the spectrum sale proceeds to the Treasury is unlikely, it is possible that towards the end of the process, the CBA voluntarily decides to carve out part of the proceeds to the government. This may come in the form of a concession, and a potential response to T-Mobile, vocal congressmen, or an FCC feeling political pressure to generate some revenue to the government. We believe that, under such a scenario, the CBA would be willing to part with an amount that would still justify a much higher stock price. The CBA holds the most leverage in the C band proceeding – assuming the FCC and Congress are aligned in having speed-to-market as their number one priority, the CBA must be on board with whatever process is ultimately enacted in an order. The CBA will be responsible for re-assigning channels to different transponders, modifying/replacing earth stations, etc. Without its support, the process will drag on for years. As a result, any concession the CBA makes in directing part of the proceeds to the US government would likely still result in a much higher stock price for Intelsat and SES, since that is likely management's primary objective. So it's possible to see 10%-15% of proceeds directed to the government, in the end, and the CBA would be willing to allow that if the final order maintains other favorable provisions to them (an opportunity to structure the auction to have enough tension to allow competitive bidding, an opportunity to sell an additional 100Mhz-200Mhz in later years, etc.)

Incentive Auction

T-Mobile and Congresswoman Doris Matsui have proposed an incentive auction, as opposed to the CBA's market-based transaction, to free up the C band for wireless usage. We think such an incentive auction carries no support within the FCC, makes no practical sense, and would fail to satisfy the FCC's desire for a speedy deployment of the C band for 5G.

To start off, it makes sense to listen to what Republican commissioners are saying in their public comments, and their statements thus far have opposed an incentive auction or a government-run auction.

In O’Rielly’s original [comments](#) during the July 2018 NPRM, he commented:

“There are, however, some things I would have done differently than what is contained in the item. As previously stated, it is of utmost importance that this proceeding is concluded and spectrum is released into the marketplace quickly. There can be no unnecessary delays or distractions. Parts of this item, while interesting, are not practical and unlikely to be adopted. I’ll just mention a couple for now. Consider that the record clearly supports a market-based approach, but the item veers off seeking comment on various auction mechanisms, many of which were not suggested in the record and some of which are incredibly complex or downright troubling. For example, those I have spoken with are scratching their heads at the transponder capacity incentive auction and are being forced to hire experts to try to make sense of it, unclear how it would work in practice. I am concerned that such ideas may detract time and attention from more viable options.”

While O’Rielly and [Carr](#) have said publicly that they would like to see more than 200MHz released, that’s not a vote in favor of T-Mobile’s incentive auction proposal but rather that a private market transaction could conceivably free up more than 200Mhz. A lower amount of released spectrum would trigger higher prices per MHz-pop; a higher amount sold could result in higher initial proceeds for the CBA. Both scenarios should translate to a much higher share price.

The T-Mobile incentive auction proposal, and also Congresswoman Doris Matsui’s similar proposal, makes little sense for a variety of reasons. First, the FCC is focused on speed in terms of transferring C band spectrum to the carriers; any government-run auction would likely take years longer than a private market transaction. The broadcast incentive auction took 7+ years to complete from start to finish. A C band incentive auction timeline would be equally lengthy. It would require the FCC to set up the detailed rules for the auction, and then hold the auction. There would be multiple rounds of forward and reverse auctions. T-Mobile’s latest proposal envisions bidding from earth station operators – registering the many operators, delineating their population counts in order to ascertain an earth station’s share of proceeds and educating them about the process will probably take years. A key advantage of the CBA is that there are two major satellite companies that utilize the C band, and they have the financial capacity to clear spectrum rapidly. Thousands of earth station operators undertaking fiber buildouts and relocating equipment in order to clear spectrum will be a lengthier process for which they have no prior experience.

Unlike the CBA proposal, the incentive auction proposal would have material impacts on current users of the C-band. To clear at least 300MHz – 500MHz throughout the US, T-Mobile proposes fundamental changes to the C-band linear broadcasting infrastructure. Antennas receiving satellite signals would be transitioned out to prevent interference, and these earth stations would be replaced by fiber. Headend locations would also envision fiber buildouts to replace satellite distribution of video content. While this may be a workable solution in a large portion of the country, many rural areas still aren’t a good fit for fiber (with the necessary redundancy) and

won't be for many years. The process of fiber buildouts adds complexities and timing delays that can be avoided for the first 200MHz if the satellite companies can simply re-engineer transponder utilization.

What are the Next Steps in the Timeline?

Our expectation is that the CBA, wireless carriers, broadcasters, and other interested parties will continue having discussions with the FCC over the next few months around what a final order will look like. Whether T-Mobile's pending merger with Sprint is approved or not will have an impact on how aggressively T-Mobile would bid in a C band auction, so if it becomes apparent that a decision on the merger will finally be made by regulators over the next few months, we could see a C band order put off until late summer.

But Republican commissioners are cognizant of the November 2020 elections, and would like to complete an order – one that would be irreversible by a Democratic FCC – well before a potential changeover. We think it unlikely that Pai and other republican commissioners would be willing to exit office in 2020 without the C band reallocation fully completed; as evidence, for instance, consider Michael O'Rielly's recent comments in [February](#):

“Another policy issue that is absorbing considerable oxygen at the Commission and elsewhere is how to go about repurposing a good portion of the existing C band satellite spectrum downlink – or 3.7 to 4.2 GHz – to provide a new mid-band spectrum play for 5G wireless services. This would be accompanied by expanding highly-popular unlicensed services into the corresponding uplink band at 6 GHz. This issue is one of my highest priorities at the Commission this year, especially given its importance in bringing needed spectrum resources to our nation's private sector wireless providers as part of the global race to 5G. Having taken a lead advocate role on the matter for quite a few years, I would appreciate any assistance you can bring to make this happen as smoothly and quickly as possible. Please know that there is near certainty that C band reallocation will occur. While the particular details are still to be worked out, this debate has matured into finding the best mechanism for reallocation and determining how quickly it can occur.”

Other Negative Headlines

Finally, we will address a variety of risks and concerns that have surfaced on occasion over the past few months.

The resignation of Preston Padden from the C-Band Alliance:

We don't view any one person as pivotal to the national liberation of the C band for 5G usage. Padden's [successor](#), Peter Pitsch, has been involved in the CBA proposal from the beginning, and is perfectly qualified to take a lead role in the FCC discussions.

Litigation Against the FCC:

The C band proceeding now has a robust record of comments, reply comments and ex partes behind it, and this paper trail will allow the FCC to defend against any lawsuits post-order. We also question whether any major players such as T-Mobile or the broadcasters would go so far as suing their own regulator over a topic that so clearly is beneficial to the national interest (ie. freeing up a 3GHz backbone for 5G deployment as rapidly as possible).

Sponsor equity offerings and CFO resignation:

Both equity sponsors BC Partners and Silverlake, as well as CFO Jacques Kerrest, have created substantial initial wealth over the past 12 months from the stock price rising from \$3 to \$15+. The sponsors have taken some chips off the table, but have still maintained 85%+ of their holdings as the important catalysts of an FCC Order and the private auction/sale unfold over the near-term (over the next 12 months in our expectation). CFO Kerrest, age 71, appears to have chosen to cash in (many of his stock options are likely priced in the low single digits) at an earlier stage. We think neither are material red flags.

Reduced potential of an outright sale prior to a final FCC order:

Having studied interactions between carriers, SatCo's and the FCC, we don't believe that private market participants would propose spectrum transactions without a private informal vetting from the FCC. Commissioner Pai appears relatively process-oriented, and we expect he would want an FCC order in place before any transaction occurs. That said, we expect the CBA to propose a band plan and somewhat detailed auction mechanisms in advance of an order, but, again, these details will have likely received a tacit nod by the FCC via private meetings discussed in ex partes prior to a public announcement.

Congressmen and Senators introducing legislation to block the CBA's proposal:

Opposing legislation by a few rogue congressmen has always been expected. However, we believe the likelihood of legislation on this issue making it through both houses of Congress and the White House is low.

5G nationalization:

Articles have re-surfaced speculating on 5G nationalization – this would be extremely unlikely and impractical (modern global 5G technology envisions carriers have exclusive private spectrum licenses) and is vocally opposed by current FCC commissioners and senior members of the [Trump](#) administration. While the earliest version of the 'nationalized 5G' concept did involve the C band, all the recent discussion has focused on a quite different vision, in which the federal government merely leases out some of its own spectrum (in completely different bands), which is currently used by the military and various agencies. Even this variation has already met with intense opposition, but it would have little direct impact on the C band. At worst, it would tend to reduce spectrum prices in the long run by introducing a bit more spectrum supply, but

only after many years spent fleshing out and implementing such a half-baked idea -- years that the country doesn't have at its disposal if it wants to keep pace in 5G.

Conclusion

A market-based transaction overseen by the satellite companies will be the fastest way of freeing up large blocks of spectrum in 3GHz for 5G usage. The CBA proposal, or some close variant of it, appears to have the vocal support of one FCC commissioner, O'Rielly, and has been favorably regarded in public comments by commissioners Pai and Carr. Over the past few months, the proceeding appears to have gathered steam, and we expect the momentum to continue, resulting in an order at some point this year. Given that we believe the C band is worth tens of billions of dollars, we think there remains substantial upside for Intelsat shares.

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