

TheMarker

May 8, 2006

From an article by Yoram Gabison

Satellite telecommunications takes off to new heights

With \$425 million worth of backlog and an agreement in the works with the Ministry of Defense for AMOS-4, Spacecom is positioning itself to climb up a rung and join the industry's merger and acquisition trend

By Yoram Gabison

Earning assets have become all the rage on the Tel Aviv Stock Exchange in 2006. Malls that most people have never heard of have been bought for sky-high prices with the intention of floating them later as REIT (real estate investment trust) funds. The lively trade in earning assets pushed up the TA Real-Estate 15 by 40 percent since the beginning of the year. An earning asset that produces a cash flow of NIS 77 million a year and operating profits of NIS 128 million annually is not bad at all by the standards of TASE players. The problem of the asset held by Space-Communications Ltd (Spacecom) is its location.

Spacecom derives its cash flow from two communications satellites, AMOS-1 and AMOS-2, which are fixed in geo-stationary orbit 36,000 Km above the Earth. They supply satellite communications services to satellite television companies such as Yes, to cable-TV companies, to the Ministry of Defense and to television channels in Eastern Europe.

That is probably why Spacecom, which is controlled by Israel Aircraft Industries, Mer Services Group, Eurocom and the Rotlevy family, trades at a market cap of NIS 336 million.

The satellite communications market has been growing at a rate of 5 to 8 percent in recent years, and is likely to see even more rapid growth over the next few years due to the gradual entrance of Central European countries to the European Union and to the growing demand for multi-channel satellite television in these countries, which lack land-based alternatives. In the context of this trend, Spacecom signed a contract with a direct-to-home (DTH) company controlled by Miloumor and Elran (35 percent each), under which it will lease space segments to DTH via the AMOS-2 and AMOS-3 satellites for a multi-channel satellite television project in Romania. The contract, which runs until 2020, is worth \$90 million and increases Spacecom's order backlog to \$428 million until 2020.

Other anticipated growth engines are the transition of broadcasts to the HDTV format, which enables a larger, sharper picture but requires a larger bandwidth, and the U.S. government's move toward leasing space segments from commercial satellites, which

raises the demand for space segments. On the negative side is the development of advanced broadcast and encoding technology that will enable the reduction of bandwidth required for television broadcasts.

"Television projects are springing up like mushrooms after a rain"

Broadband satellite communications services are likely to be one of the satellite TV companies' primary weapons in their attempt to counter video-on-demand (VOD) service, which gives the cable TV companies a relative advantage. "Satellite television projects are springing up like mushrooms after a rain," says David Pollack, CEO of Spacecom. "Everyone is competing against cable and everyone has the same problem as Yes when it comes to the cable companies' VOD service."

The problem will be on its way to a solution in the beginning of 2008, when the AMOS-3 satellite starts to lease space segments in Ka-band frequencies delivered by two broadband transponders of 500 megahertz. These transponders will allow satellite television companies to offer a service similar to VOD, utilizing the bandwidth provided by the satellite for the high-frequency transmission and refreshment of a list of hundreds of movies to subscribers' hard discs, like the service offered by Yes-Max.

The satellite TV companies' alternative solution to the problem of VOD is Internet Protocol TV (IPTV), which uses landline communications infrastructure. Pollack rejects the assessment that this solution is liable to harm the business model of Spacecom and similar companies.

Spacecom markets the space segment of AMOS-1, which covers the Middle East and Eastern and Western Europe, for Israel Aircraft Industries and thus reaps only modest commissions.

However, Spacecom plans to transfer all of AMOS-1's clients to AMOS-3, following the inking of an agreement with IAI according to which Spacecom and IAI will make joint use of the European beams of the AMOS-1 and AMOS-2 satellites and will share in the revenues. IAI will receive 40 percent of those revenues, starting from January 2005 until the demise of AMOS-1. Spacecom's sacrifice of the revenues stems from its realization that when AMOS-3 goes into operation, all of IAI's AMOS-1 clients will move over to the new satellite and the government company will not earn anything at all from AMOS-3.

Spacecom also owns AMOS-2, which was launched in December, 2003, and covers the Middle East, Europe and the United States. With a current occupancy rate of 90 percent, it will supply 22 space segments through the end of 2016.

The two satellites generated revenues of NIS 157 million for Spacecom in 2005. Spacecom is expected to reach an annual turnover of \$70 million to \$80 million starting in the first half of 2008, in the wake of the launch of AMOS-3 at the end of 2007 to replace AMOS-1.

Pollack is not satisfied with the expected rise and is seeking out the next rung on the ladder, one that will significantly increase the company's value.

"We're doing all the right things, but the minute there's a television venture that's not connected with Israel, international bodies will start to take an interest in us. That type of venture is likely to be, for example, a project for a satellite television company in a country whose potential is 20 to 50 times greater than Israel's. The company would be interested in having a satellite built for it and would commit to leasing 33-50 percent of the satellite's capacity, functioning as an anchor client," Pollack says.

One venture likely to take a step in this direction is the trilateral agreement that is taking shape between Spacecom, an Eastern European television company and Globecast, a subsidiary of France Telecom that supplies video content via leased satellite segments in 30 satellites around the world and a fiber-optic network. . The three-way agreement will be based on a revenue-sharing model with GlobeCast and possibly with the DirecTV through the sale of broadcasts to the channel's subscribers. This model shows potential for a growth in revenues, but also presents greater risks compared to the regular model, whereby satellite segments are leased to clients for a fixed price.

Expansion of the AMOS satellites' beam coverage to areas such as the Far East and the possibility of creating connections between the various beams will gradually make Spacecom's communications infrastructure package more attractive, and in the long-term future, will position the company to ride the M&A wave that has characterized the industry for the past two years.

"Currently, Spacecom is a \$75 million company but I believe we'll get an acquisition offer within the next five years," Pollack says.