From selling houses to buying satellites

By Paul Brown-Kenyon, Chief Operating Officer, MEASAT

EVERY year, billions of dollars of debt is raised by satellite operators to finance the purchase of new satellites.

And this makes financial sense with debt a capitally efficient approach to fund large investments able to provide a steady cash flow over an extended period. For project based investments, operators will typically put up 30% of the project cost with the remaining 70% being financed by banks. More debt can be justified for replacement satellites – with customers and hence cashflow already secured – while more equity would be needed for ventures where there is higher risk and less appetite from debt holders to underwrite that risk.

But in addition to this use of debt to purchase satellites, debt has also been used over the last few years by financial firms looking for short term profit from the industry. Private Equity firms, buying into global satellite operators, have used debt to fund these purchases and extract value from the companies they have acquired. Venture Capital firms, seeing opportunities in the industry, have used various types of debt to help finance companies starting new businesses in the same area. Such moves are natural and, if based on reasonable set of assumptions, are good for the long term development of the industry. But if debt is such an important component of satellite finance how will the 'credit crunch' that we have heard so much about over the last few months impact the industry? To understand the potential impact we need to understand what generated the 'crunch'.

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It started from an over-exuberance and then slowdown in the US housing market leading to an increasing number of defaults on the mortgages held by the, now famous, sub-prime (higher risk) borrowers. Where traditionally, these mortgages would have been held by mortgage companies, today they are often packaged by financial intermediaries into new financial assets and then sold on which, in a financial sophisticated market, is all well and good.

The problem, however, is that the purchasers of these assets often did not have a clear sense of the risk of the asset. Believing that the assets were relatively secure, hedge funds and banks have since discovered the assets risk during a housing downturn with investments in these financial instruments suddenly wiped out. These losses, and concerns over who else is exposed indirectly to the US housing markets, has led to a general loss of confidence in the inter-bank debt market with banks hoarding cash rather than lending to other banks.

While the core issue may have been addressed through injections of liquidity by the central banks and reduction in the central bank interest rates, there is now a lot more caution in the debt markets and less appetite to take on risky projects.

So, given this situation, what has or will be the impact on the global satellite industry? For the majority of satellite operators, I would argue the impact is limited. Yes, debt may become a little more expensive, and the hurdle rate of return for new satellites may be increased to reflect additional costs of capital and some uncertainty in the direction of the global economy, but impacts on most operators with existing businesses and good cash flow will be limited.

There is a potential bigger impact, however, on some of the financial players in the industry who have refinanced satellite operators, taking out cash and replacing it with large amounts of debt. This is because the strategy, which has been pushed closer and closer to the limit in the search for value, has been based on the continued availability of cheap money and growth in the global economy. The change in the debt

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markets has made these deals, in retrospect, look a lot more risky. In an environment where the markets are now pricing risk much more expensively, this could have implications. At best, this would lead to a reduction in profitability and a hold back in future investment as these operators try to preserve their cash to service their growing debt. At worst, it could lead to further industry re-structuring in an attempt to return the companies to a long term sustainable capital structure.

But there is a silver lining. The long term effect of the recent movements in the debt markets will be an increased focus on the fundamentals of the business and the quality of operations. This is always going to be good for the long term sustainable growth of the industry. TVasia