

Intelsat S.A. (INTEL)

2Q 2014: EBITDA Better, Sales Pressures Extend, 8.5% Bonds YTC?

- Citi's Take** — Intelsat's (INTEL; OW) results were mixed with lower sales and pleasantly surprising higher EBITDA. We believe fundamentals continue to support our "carry trade" thesis until revenue growth resumes (in 2015 / 2016). Intelsat has \$10.3 billion contracted backlog which represents over 4 years revenue. Network services sales slid 5% year-over-year (continuing weakness in Africa), and softness still expected 2015. Intelsat-30 will launch in early 4Q and contribute unquantified revenue in 4Q; however, key capacity additions occur in 2016 & 2017. Management raised their debt repayment target to \$475 million (from \$400 million). The company cited the \$500 million 8.5% Jackson notes due 2019 (first callable November 1st at 104.25) as the highest coupon they pay, but have made no decisions yet.
- Credit Implications** — We maintain our Overweight weighting on Intelsat credit owing to projected stable fundamentals, industry leading position, and relative value opportunities. We maintain our Buy ratings on the higher yield Jackson 5.5% and 6.625% bonds, and the Luxembourg 7.75% and 8.125% notes. On a relative value basis, the 6.625% bonds seem most attractive owing to modest leverage increase for the yield pick-up within the Jackson structure. Intelsat's secured term loan B offers attractive relative value and is 1.5x leveraged. We maintain our Neutral recommendation on the Jackson 7.5% and Luxembourg 6.75% which could be YTC, but trade about 100bp wider than our Sell rated bonds. We maintain our Sell recommendation for Jackson bonds due 2019-2020 which are YTC bonds with first calls between November and October 2015.

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Figure 1. Intelsat Credit Pricing

Cpn (%)	Description	Maturity	Rating	Moody's / S&P	Amt Out (\$mm)	Current Prices			
						Bid	YTW (%)	STW (bp)	YTW Date
Jackson									
L+275bp, 1%	1L TL B2	30 June 2019		Ba3(S) / BB	3,095	99.250	3.91%		
7.250	Gtd Sr Nts	1 April 2019	Sell	B3(S) / B+	1,500	104.625	5.34%	482	4/1/2016
8.500	Gtd Sr Nts	1 November 2019	Sell	B3(S) / B+	500	104.750	5.94%	574	11/1/2014
7.250	Gtd Sr Nts	15 October 2020	Sell	B3(S) / B+	2,200	105.250	5.60%	523	10/15/2015
7.500	Gtd Sr Nts	1 April 2021	Neutral	B3(S) / B+	1,150	106.000	5.82%	530	4/1/2016
5.500	Gtd Sr Nts	1 August 2023	Buy	B3(S) / B+	2,000	94.750	6.27%	385	8/1/2023
6.625	Sr Nts	15 December 2022	Buy	Caa1(S) / B-	1,275	100.000	6.62%	461	12/15/2020
Luxembourg									
6.750	Sr Nts	1 June 2018	Neutral	Caa2(S) / B-	500	103.250	5.48%	446	6/1/2017
7.750	Sr Nts	1 June 2021	Buy	Caa2(S) / B-	2,000	101.250	7.43%	576	6/1/2019
8.125	Sr Nts	1 June 2023	Buy	Caa2(S) / B-	1,000	102.000	7.74%	567	6/1/2021

Source: Citi Research

- What's Inside This Report?** On the following pages we include: conference call highlights; quarterly 2014 & annual 2015 forecasts; projection update; detailed 2Q review; and capital structure.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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2Q 2014 Review & Outlook

Conference Call Highlights

- Intelsat-30 is expected to launch in early 4Q and will enter service during 4Q. We estimate minimal revenues to be conservative. This satellite will service a leading direct-to-home broadcaster in Latin America. The next scheduled launch is 2H 2015.
- Network services review remains under pressure in Africa, and limited capacity in the growth areas (broadband mobility, aerospace & maritime mobility). New capacity is anticipated in 2016 & 2017.
- Intelsat 8.5% Jackson bonds due 2019 are first callable on November 1st at 104.25 and could be a target for the company's \$475 million debt repayment (increased from \$400 million). The company could also paydown bank debt. A decision will be made later in the year.

Figure 2. Intelsat Financial Summary

	Fiscal Year End			Quarterly				Fiscal Year End	
	12/31/2011	12/31/2012	12/31/2013	3/31/2014	6/30/2014	9/30/2014	12/31/2014	12/31/2014	12/31/2015
	2011A	2012A	2013A	1Q14	2Q14	E-3Q14	E-4Q14	2014E	2015E
Operating Statistics									
Total Sales	\$2,588	\$2,610	\$2,604	\$629	\$616	\$617	\$623	\$2,485	\$2,476
Growth	1.7%	0.8%	(0.3%)	(4.0%)	(5.8%)	(5.3%)	(3.0%)	(4.5%)	(0.4%)
EBITDA	\$1,971	\$1,996	\$2,023	\$505	\$489	\$485	\$490	\$1,969	\$1,936
Margin	76.2%	76.5%	77.7%	80.4%	79.4%	78.5%	78.6%	79.2%	78.2%
Interest Expense	\$1,309	\$1,267	\$1,114	\$241	\$239	\$245	\$245	\$970	\$978
Capital Expenditures	\$845	\$830	\$588	\$167	\$186	\$166	\$166	\$684	\$800
Capex (% of revenue)	32.6%	31.8%	22.6%	26.5%	30.2%	26.8%	26.6%	27.5%	32.3%
Cash & Cash Equivalents	\$295	\$187	\$248	\$435	\$370	\$635	\$632	\$632	\$1,010
Secured Debt	\$3,234	\$3,218	\$3,095	\$3,095	\$3,087	\$3,080	\$3,072	\$3,072	\$3,041
Guaranteed Jackson Debt	\$10,137	\$9,574	\$10,445	\$10,445	\$10,437	\$10,430	\$10,422	\$10,422	\$10,391
Intelsat Jackson Debt	\$10,119	\$10,218	\$11,724	\$11,724	\$11,717	\$11,709	\$11,701	\$11,701	\$11,670
Total Debt	\$16,002	\$15,903	\$15,287	\$15,274	\$15,267	\$15,259	\$15,251	\$15,251	\$15,220
Net Debt	\$15,708	\$15,716	\$15,040	\$14,839	\$14,896	\$14,624	\$14,619	\$14,619	\$14,210
Credit Statistics									
				LTM	LTM	LTM	LTM		
Secured Debt / EBITDA	1.6x	1.6x	1.5x	1.5x	1.5x	1.5x	1.6x	1.6x	1.6x
Guaranteed Jackson Debt / EBITDA	5.1x	4.8x	5.2x	5.1x	5.2x	5.2x	5.3x	5.3x	5.4x
Jackson Debt / EBITDA	5.1x	5.1x	5.8x	5.8x	5.8x	5.9x	5.9x	5.9x	6.0x
Luxembourg Debt / EBITDA	7.8x	7.8x	7.5x	7.5x	7.6x	7.6x	7.7x	7.7x	7.8x
Total Debt/LTM EBITDA	8.1x	8.0x	7.6x	7.5x	7.6x	7.7x	7.7x	7.7x	7.9x
Net Debt / EBITDA	8.0x	7.9x	7.4x	7.3x	7.4x	7.4x	7.4x	7.4x	7.3x

Source: Company Reports and Citi Research Estimates

Projection Update

- We modestly lowered our sales estimates owing to remaining challenges within the network services sector. Our revised 3Q estimates include: \$617 million sales (prior: 622); and \$245 EBITDA (prior: 245);
- Our revised 2014 forecasts include: \$2,485 million sales (prior: 2,499); \$1,969 million EBITDA (prior: 1,968); 5.9x Jackson leverage; and 7.7x Luxembourg.
- Our revised 2014 forecasts include: \$2,476 million sales (prior: 2,518); \$1,936 million EBITDA (prior: 1,975); 6.0x Jackson leverage; and 7.9x Luxembourg.
- Intelsat affirmed its revenue and capex guidance, while improving its EBITDA margin and debt paydown forecast including: \$2,450 – 2,500 million sales; 78-79% EBITDA margins; \$625 – 700 million capex; \$125 – 150 million customer prepayments (for capex); and \$475 million debt paydown (prior: 400). Intelsat declined to answer when revenue could rise year-over-year and did not quantify the potential revenue impact for Intelsat-30 (to launch in early 4Q).

Intelsat's \$616 million sales were below the \$621 million consensus and our \$622 million estimate. Intelsat's backlog is 4.1x LTM sales.

Figure 3. Intelsat Revenue Review

(\$ in millions)		6/30/2013 2Q13	3/31/2014 1Q14	6/30/2014 2Q14	Change	
					Y/Y	Q/Q
Total Sales		\$654	\$629	\$616	(\$38)	(\$13)
	Change				-5.8%	-2.1%
Network Services		\$304	\$290	\$287	(\$16)	(\$3)
	Change				-5.3%	-1.0%
Media		\$221	\$222	\$217	(\$3)	(\$5)
	Change				-1.6%	-2.1%
Government		\$122	\$109	\$104	(\$19)	(\$5)
	Change				-15.3%	-4.8%
Other		\$7	\$8	\$8	\$0	(\$0)
	Change				5.6%	-4.0%
Contracted Backlog		\$10,400	\$9,900	\$10,300	(\$100)	\$400
	Change				-1.0%	4.0%
LTM Sales		\$2,636	\$2,577	\$2,539	(\$97)	(\$38)
	Change				-3.7%	-1.5%
Contracted Backlog / LTM Sales		3.9x	3.8x	4.1x	0.1x	0.2x
	Growth				2.8%	5.6%

Source: Company Reports and Citi Research Estimates

Intelsat missed our network services estimate, while media & government segments were in line.

Intelsat's \$490 million EBITDA was ahead of \$484 million consensus and in line with our \$491 million estimate.

Figure 4. Intelsat EBITDA Review

(\$ in millions)		6/30/2013 2Q13	3/31/2014 1Q14	6/30/2014 2Q14	Change	
					Y/Y	Q/Q
Total Sales		\$654	\$629	\$616	(\$38)	(\$13)
	Change				-5.8%	-2.1%
EBITDA		\$505	\$505	\$489	(\$16)	(\$16)
	Change				-3.1%	-3.2%
EBITDA Margin (%)		77.2%	80.4%	79.4%	224 bp	-94 bp
	Change				2.9%	-1.2%
Gross Profit		\$554	\$545	\$529	(\$25)	(\$16)
	Change				-4.5%	-3.0%
Gross Margin (%)		84.7%	86.7%	85.9%	120 bp	-82 bp
	Change				1.4%	-0.9%
SG&A		\$125	\$47	\$45	(\$81)	(\$2)
	Change				-64.3%	-4.6%
SG&A (% of revenue)		19.2%	7.4%	7.3%	-1189 bp	-19 bp
	Change				-62.1%	-2.6%
Depreciation & Amortization		\$187	\$170	\$169	(18)	(1)
	Change				-9.5%	-0.4%
Stock-based Compensation		\$18	\$4	\$5	(13)	1
	Change				-72.7%	26.1%

Source: Company Reports and Citi Research Estimates

SG&A was lower than our forecast owing to a one-time \$3 million bad debt collection.

There were no "special" EBITDA adjustments in the quarter for the first time since 4Q 2012.

Free cash flow improved \$51 million to negative \$56 million owing to higher operating cash flow, partially offset \$17 million higher capex.

Figure 5. Intelsat Cash Flow Review

(\$ in millions)		6/30/2013 2Q13	3/31/2014 1Q14	6/30/2014 2Q14	Change	
					Y/Y	Q/Q
Operating Cash Flow		\$63	\$367	\$130	\$68	(\$236)
	Change				107.4%	-64.4%
Capital Expenditures		\$169	\$167	\$186	\$17	\$19
	Change				10.1%	11.6%
Operating Cash Flow less Capex		(\$106)	\$200	(\$56)	\$51	(\$256)
	Change				-47.6%	-127.8%
Cash Interest		\$410	\$90	\$400	(\$10)	\$310
	Change				-2.5%	345.8%
Change in Working Investment		\$290	(\$29)	\$26	(\$264)	\$54
	Change				-91.1%	-190.6%

Source: Company Reports and Citi Research Estimates

Intelsat has higher cash interest payments in 2Q & 4Q (about \$400 million) versus 1Q & 3Q (about \$90 million).

Leverage ticked up 0.1x to 5.8x Jackson and 7.6x Luxembourg owing to EBITDA declines (as anticipated).

Figure 6. Intelsat Leverage Review

(\$ in millions)		6/30/2013 2Q13	3/31/2014 1Q14	6/30/2014 2Q14	Change	
					Y/Y	Q/Q
EBITDA		\$505	\$505	\$489	(\$16)	(\$16)
	Change				-3.1%	-3.2%
Cash & Cash Equivalents		\$96	\$435	\$370	\$275	(\$65)
	Change				286.6%	-15.0%
Secured Debt		\$3,202	\$3,095	\$3,087	(\$115)	(\$8)
	Change				-3.6%	-0.3%
Guaranteed Jackson Debt		\$10,552	\$10,445	\$10,437	(\$115)	(\$8)
	Change				-1.1%	-0.1%
Intelsat Jackson Debt		\$11,831	\$11,724	\$11,717	(\$115)	(\$8)
	Change				-1.0%	-0.1%
Intelsat Luxembourg Debt		\$15,331	\$15,224	\$15,217	(\$115)	(\$8)
	Change				-0.7%	-0.1%
Net Debt		\$15,312	\$14,839	\$14,896	(\$415)	\$57
	Change				-2.7%	0.4%
Secured Debt / EBITDA		1.6x	1.5x	1.5x	0.0x	0.0x
	Growth				-3.1%	0.5%
Guaranteed Jackson Debt / EBITDA		5.2x	5.1x	5.2x	0.0x	0.0x
	Growth				-0.6%	0.7%
Jackson Debt / EBITDA		5.8x	5.8x	5.8x	0.0x	0.0x
	Growth				-0.5%	0.7%
Luxembourg Debt / EBITDA		7.6x	7.5x	7.6x	0.0x	0.1x
	Growth				-0.3%	0.7%
Net Debt / EBITDA		7.6x	7.3x	7.4x	-0.2x	0.1x
	Growth				-2.2%	1.2%

Source: Company Reports and Citi Research Estimates

Intelsat's capital structure is fully leveraged with about one turn of equity value. Secured debt enjoys 5.4x asset coverage and is attractive on a relative value basis.

Figure 7. Intelsat Capital Structure & Liquidity

	6/30/2014 2Q14	Gross Leverage	Net Leverage	Bid Price	YTW	Rating
Cash & Cash Equivalents	370					
\$450M Sr. Sec. RC @ L+275bps, 1.00% floor due 7/12/2017	0					
Sr. Sec. TL B2 @ L+275bps, 1% floor due 6/30/2019	3,087			\$99.250	3.91%	
Secured Debt	3,087	1.3x	1.5x			
7.25% Sr. Notes due 4/1/2019(Gtd. by Sub. HoldCo)	1,500			\$104.625	5.34%	Sell
8.5% Sr. Notes due 11/1/2019 (Gtd. by Sub. HoldCo)	500			\$104.750	5.94%	Sell
7.25% Sr. Notes due 10/15/2020 (Gtd. by Sub. HoldCo)	2,200			\$105.250	5.60%	Sell
7.5% Sr. Notes due 4/1/2021 (Gtd. by Sub. HoldCo)	1,150			\$106.000	5.82%	Neutral
5.5% Sr. Notes due 8/1/2023 (Gtd. by Sub. HoldCo)	2,000			\$94.750	6.27%	Buy
Guaranteed Jackson Debt	10,437	5.8x	5.0x			
6.625% Sr. Notes due 12/15/2022	1,275			\$100.000	6.62%	Buy
Other	4					
Intelsat Jackson Debt	11,717	7.6x	5.6x			
6.75% Sr. Notes due 6/1/2018	500			\$103.250	5.48%	Neutral
7.75% Sr. Notes due 6/1/2021	2,000			\$101.250	7.43%	Buy
8.125% Sr. Notes due 6/1/2023	1,000			\$102.000	7.74%	Buy
Intelsat Luxembourg Debt	15,217	7.6x	7.4x			
Other/New Dawn	50					
Total Debt	15,267	7.6x	7.4x			
Market Equity Value	1,911		0.9x			
less: Cash & Cash Equivalents	(370)					
Enterprise Value	16,807		8.4x			

Source: Company Reports and Citi Research Estimates

Appendix A-1

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Intelsat S.A. (INTEL) — Issuer Portfolio Weighting and Issue Rating History

High Yield Credit Research

Analyst: David Phipps

Issuer		Issue			
Weighting	Date	Coupon	Description	Maturity	Rating
OW	19-Jul-13	6.750%	Sr Nts	01-Jun-18	Neutral (2)
		7.750%	Sr Nts	01-Jun-21	Buy (1)
		8.125%	Sr Nts	01-Jun-23	Buy (1)
		6.625%	Sr Nts	15-Dec-22	Buy (1)
		8.500%	Sr Nts	01-Nov-19	Sell (3)
		7.250%	Sr Nts	01-Apr-19	Sell (3)
		7.250%	Sr Nts	15-Oct-20	Sell (3)
		7.500%	Sr Nts	01-Apr-21	Neutral (2)
		5.500%	Sr Nts	01-Aug-23	Buy (1)

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