

Iridium Communications Inc. (IRDM) 1-Page Summary

Value Criteria: Iridium Communications Inc. (IRDM) exhibits characteristics of an undervalued stock. With a P/E ratio of 6.2x and a P/B of 0.7x, IRDM meets both financial criteria. Additionally, IRDM has a market cap of \$1.1 billion which just meets the small-cap obscurity criteria for US companies (Exhibit 1). Although IRDM is covered by eight analysts, none are from major financial institutions and only three called into the Q4 2017 earnings call. Furthermore, IRDM has seen recent distress, being forced to issue a below investment grade tranche of debt related to increased capital expenditure requirements and to repay a deferred payment obligation. Overall, this appears to be a classic Ben Graham value stock, where the replacement value of assets is above current market price. Therefore, we have decided to proceed with IRDM as our selected value company.

Industry: We believe IRDM has medium business risk. The high debt load, tied-up capital in non-operational assets, and the inherent risk of launching satellites into space are riskier aspects of the industry. Satellite infrastructure operators have a B2B business model often locking in long-term service contracts with retail partners who markup and re-sell services to end users. IRDM is currently in a higher-risk stage, because it is in the midst of an upgrade cycle with imminent launches of its unique Iridium NEXT system. However, high industry margins, long-term contracts, stable customers and revenue streams all imply a lower risk level. A significant portion of IRDM's revenue comes from government and commercial clients that have high switching costs. Combining these elements, we established that IRDM has medium business risk. Medium business risk implies an optimal capital structure of 30-49% debt to total capitalization. We calculated IRDM's target capital structure as 47.6% averaging between FY2010-FY2017 (Exhibit 2). IRDM formally listed on the NASDAQ in FY2010, which represented a fundamental change in capital structure. This target capital structure placed IRDM at medium financial risk. Medium business risk and medium financial risk would usually result in an 'A' - 'BBB' credit rating. However, IRDM's current corporate credit rating sits at 'B-', and its recently issued senior unsecured notes were rated 'CCC'. Based on a risk-free rate of 2.82% (US 10-year), and a spread of 3.68% (corporate 'B-' spread) we calculated pre-tax cost of debt of 6.50%. IRDM's risk profile gave it an equity risk premium of 5%, resulting in a cost of equity of 11.50%. Accounting for a corporate tax rate of 21%, which only includes the federal rate as Delaware has no state tax, and using target capital structure, WACC was calculated to be 8.47% (Exhibit 3). First-pass ROIC was calculated to be 14.37%, higher than WACC (Exhibit 4).

Valuation: We valued IRDM using the NAV method at \$17.92 per share (Exhibit 5). The EPV method yielded a share price of \$10.08 (Exhibit 6). The 2nd ROIC calculation confirmed this, with a ROIC of 4.51% which is now lower than WACC at 8.47% (Exhibit 7).

Catalyst/Franchise: Since NAV is above the EPV valuation, we have determined a catalyst exists that could drive up future earnings. We believe excess capacity exists at both the industry and firm level. The MSS industry is undergoing an upgrade cycle, and due to the long development cycle, redundant capacity exists. This applies to IRDM as well, who have their first-generation system, as well as their partially operational Iridium NEXT system in orbit. Once operational in late-2018, barring any deployment complications, the old system will be taken offline, reducing said excess capacity. Long-term contracts will then be generating revenue, debt paid down, and margins projected to increase. We believe this is very likely to occur, as IRDM has explicitly stated that they will be taking their old system offline immediately after NEXT's deployment. The rest of the industry should follow suit with taking old systems offline to avoid carrying these assets once they are obsolete. Therefore, we have given the catalyst a high probability of occurring, valued at 80%.

Entry Price and Recommendation: $(\$17.92 - \$10.08) \times 80\% + 10.08 \times (2/3) = \mathbf{\$10.90}$ (Exhibit 8)

Overall, it is recommended that we do not buy this stock at the current price. IRDM currently trades at \$11.30, which is slightly above our entry price of \$10.90, but may dip under in the near future.