

Cove Street Capital

Adventures in Contrarian Value Investing

January 2021



Safe Harbor



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Cove Street Capital, LLC is a registered investment adviser. More information about us is located in our ADV Part 2, which is on our website or upon request:

<http://covestreetcapital.com/faq/>

Agenda

- Introduction to presenters and to Cove Street Capital
- Discussion of Cove Street's Process and Philosophy
- Brief Market Commentary
- Deep Dive into the Business and Valuation of Viasat (ticker: VSAT)
- Risk and Myths Associated with VSAT
- Q&A

Presenters

- Ben Claremon (no CFA)

- Ben Claremon joined Cove Street in 2011 as a research analyst. He also serves as a Co-Portfolio Manager for our Classic Value | Small Cap Plus strategy. Previously he worked as an equity analyst on both the long and the short side for hedge funds Blue Ram Capital and Right Wall Capital in New York and interned at West Coast Asset Management in Santa Barbara. Prior to that, he spent four years with a family commercial real estate finance and management business. Mr. Claremon was also the proprietor of the value investing blog, The Inoculated Investor. His background includes an MBA from the UCLA Anderson School of Management and a BS in Economics from the University of Pennsylvania's Wharton School.

- Eugene Robin, CFA

- Full disclosure: Eugene and his father both worked at VSAT—the stock we will discuss later
- Eugene Robin, CFA is a Principal at Cove Street Capital and works on both the Small Cap Value strategy as well as the Micro Cap Value strategy for the firm. Prior to Cove Street, Eugene worked for the family office of a prominent Kuwaiti family as an investment analyst and was responsible for diligence on a large investment portfolio which included hedge funds, bonds, equities and real estate. Eugene worked for ViaSat as a software engineer before earning his MBA in Finance from UCLA Anderson School of Management. He also holds a BA in Computer Science from UC San Diego.

Cove Street Capital

- Cove Street Capital (“CSC”) is an LA-based, SEC-registered investment adviser founded in 2011
 - 100% employee owned
 - ~\$700 million under management
- Concentrated, Small/SMID Cap U.S. value focus
 - 30-39 stocks in Classic Value Small Cap
 - 20-29 stocks in Small Cap PLUS (SMID)
- 3 pillars: Business, Value, People
- Website: <http://covestreetcapital.com/>
 - More interviews and podcasts:
<http://covestreetcapital.com/blog/podcasts-recordings/>
 - More on Viasat (VSAT):
<http://covestreetcapital.com/eugene-robin-discusses-viasat-on-the-valuewalk-podcast/>

Investment Philosophy

- Classic fundamental, research-driven value investing
- Concentrate on best ideas
- Think and act long-term: 3-to-5-year (but ideally forever) time horizon
 - Mathematics of compounding
 - Less is more
- Do a lot of work and perform non-Wall Street due diligence
- Good corporate governance and rational capital allocation are hugely important
- Key investment questions:
 - Is this a high return company that is getting more valuable each day?
 - Is this company run by honest people who understand capital allocation?
 - Is the stock undervalued based on conservative assumptions about the future?

4 Stage Investment Process

Generating Ideas

- Screen for both good businesses & cheap stocks
- Screen for behavioral anomalies/companies in transition
- Collective investment experience/contact network/out of office experiences/management meetings

Qualify

- Read: 10-K, conference calls, proxy statement, company presentations
- CSC Capital IQ-linked analytic spreadsheet
- Buffett stock: good business at a reasonable price--an 85 cent dollar
- Graham stock: cheap security (a 50 cent dollar) that provides a large enough margin of safety?

4 Stage Investment Process

Deep Dive

- Extensive qualitative team tackle by generalists: 2 long, 1 short
- Triangulate intrinsic value
 - DCF, SOTP, multiples analysis
- Sustainable competitive advantage?
- C-PEST analysis—Climate, political, economic, social, technological risks

Decision

- Full or half position?
 - 2.5% or 5% in small cap
 - 2.5%, 5% or 7.5% in SMID
- Margin of safety
- Sufficient risk-adjusted upside
- Establish sell discipline
- Record your decisions and revisit them over time

Market Commentary

- Bottom up—not macro—investors but we pay attention to what is going on
- Signs of speculative fervor and irrational exuberance
 - SPACs, IPOs, electric vehicles/Tesla, Bitcoin, Reddit threads—GME!!!
 - Extreme valuations not just in tech though—“quality” has become really expensive as well
 - There remains a “1999/2000” sized gap between small cap value and large cap growth
- Low interest rates...low interest rates...low interest rates
 - TINA= There is No Alternative (to owning stocks)
 - Low rates, nearly free credit → M&A boom for small cap?
 - Will domestic money printing ever lead to inflation?
- Impact of corporate tax rates going back up?
- Still finding value in stocks where people overweight disruption risk
 - Be a contrarian but be HIGHLY selective

Viasat, Inc. Ticker: VSAT

A Path Upwards



Best Idea — Viasat

Price/Share: \$40
CSC Target: \$110 - \$120

This is arguably one of the most compelling investment opportunities in our firm's history and is again the largest position in our small cap strategy.



Cove Street Capital and its Principals have owned and researched Viasat for 20 years.



The market underappreciates the internal Intellectual Property (IP) of a complicated and opaque company in a grossly misunderstood industry.

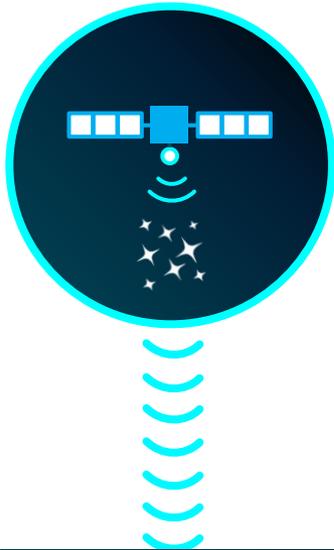


There is a massive spread between current cash flow and incumbent position in the sky... and endless hype and blathering about an untested space future—in which VSAT may actually play a crucial role.



Government Systems, Viasat's defense business, has been on a multi-year tear and is arguably worth \$46 per share on its own, implying little—if any—value for the remaining business lines.

The Business



Developed the **High Throughput Satellite** (HTS), a breakthrough communications satellite that dramatically increased speed and capacity while also significantly reducing cost, creating:

- the modern HTS industry
- high-performing **Satellite Services** :

Faster, Cheaper
**Government
Aircraft
Service**

First-Ever
**In-Flight
Connectivity
System**

Affordable
Remote & Rural
**Community
Wifi**

Direct to
Home(DTH)
**Consumer
Broadband**

The Business

SATELLITE SERVICES

Government
Aircraft
Service



Massive increase in speed delivered

Reducing cost per bit for military customers by factor of 100



In-Flight
Connectivity
System (IFC)



Delivering 12mbps to the seat

Currently on 1,300+ planes



Remote
Community
Wifi



Remote WiFi internet services

Underserved communities in Mexico and Brazil



DTH
Consumer
Broadband



Speeds greater than most DSL

Price point comparable to cable

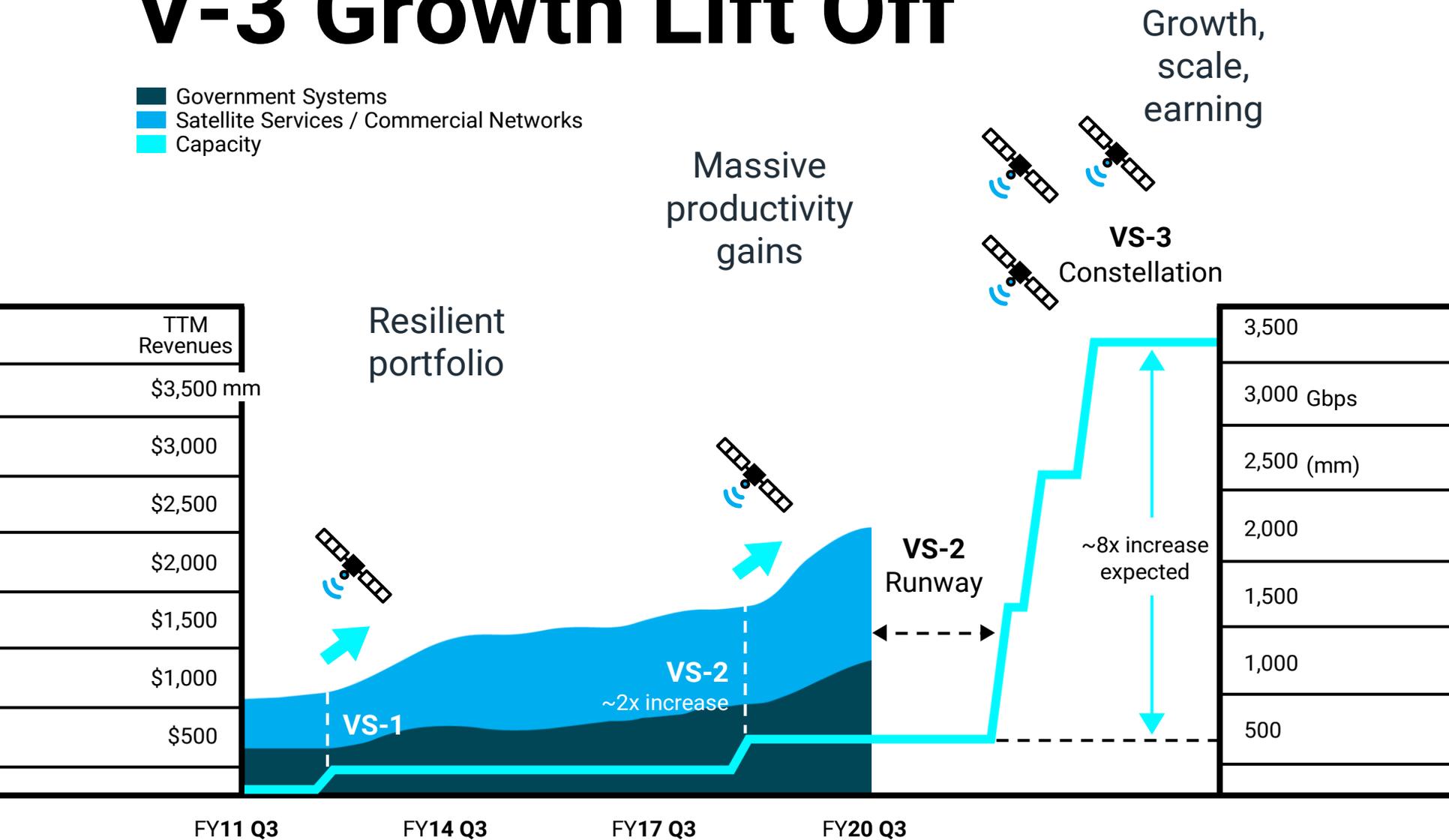
Nearly 600,000 customers in the U.S.



FY20 → FY23 Projected Roadmap

V-3 Growth Lift Off

- Government Systems
- Satellite Services / Commercial Networks
- Capacity

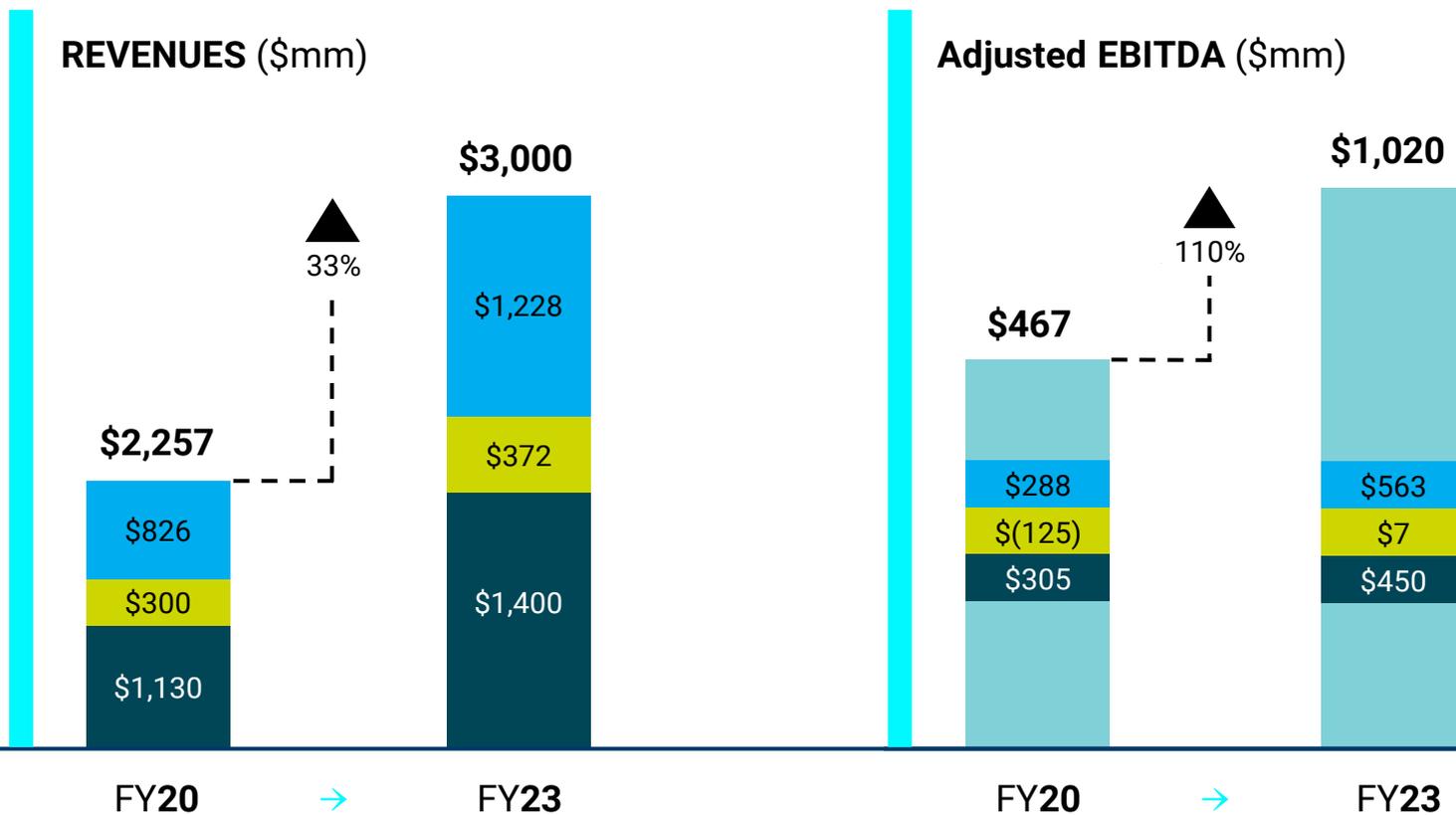


SOURCE: Viasat

FY20 → FY23 Projected Roadmap

V-3 Growth Lift Off

Government Systems Commercial Networks Satellite Services Total



SOURCE: Viasat

Satellite Services



EXISTING

- Consumer Broadband
- In-Flight Connectivity (IFC)
- Cheap Community Wi-Fi
- International Connectivity



POTENTIAL

- Maritime
- Oil & Gas
- 5G Backhaul
- Business services

Satellite Services



EXISTING

Consumer Broadband)))))))

Fixed wireless internet for the home



In-Flight Connectivity (IFC)



Non-residential revenue now at 25% of segment (Q3:2020) and growing rapidly

Rural Community Wi-Fi

International Connectivity

Satellite Services



EXISTING

Consumer Broadband

In-Flight Connectivity (IFC)

Rural Community Wi-Fi

International Connectivity



» Internet connections in the air

IFC and services are driving diversification in **Satellite Services Revenue** (\$mm)

■ IFC & Other
■ Fixed Broadband
■ IFC & Other (%)



SOURCE: Viasat

Viasat —

Satellite Services



EXISTING

Consumer Broadband

In-Flight Connectivity (IFC)

Cheap Community Wi-Fi

International Connectivity))))



Infrastructure for worldwide connection

Expanding footprints and distribution in Americas and Europe



SOURCE: Viasat

GEO Competitor Price Check — Lowest Wins!



Cost per bit dynamics favor Viasat versus all GEO competitors:

■ Viasat Satellites ■ The Other Guys

COST PER GBPS (\$mm)



SOURCES: ■ Internal CSC estimates ■ Public statements

Competitors' Current Status

LEO Hype vs. Reality



	In Orbit?	% Complete as of 12/2020	\$ Raised	% Est. \$ Needed	Backers
Telesat	No	0%	\$600mm	20%	Company's cash
OneWeb SoftBank	Yes, partial	6.2%	\$3.4B	78%	SoftBank, Grupo Salinas, Qualcomm, Airbus, Virgin Group, Hughes
Starlink* SpaceX	Yes, partial	21.7%	\$1.45B split with SpaceX	N/A	Ontario Teachers Pension, Baillie Gifford, BofA, Fidelity, Google
Kuiper Amazon	No	0%	\$1B/year with Blue Origin	N/A	Amazon

Exited Bankruptcy

*SpaceX Starlink numbers contingent on model assumptions outlined on the following page.

SOURCE: CSC Internal Estimates / Public Statements

Starlink Key Variables

"I want to be the first non-bankrupt LEO"
— Elon Musk



	ASSUMPTION	STATUS as of March 2020
Inter Satellite Links (ISL) Laser based satellite-to-satellite communications	Maximum capacity in orbit	No ISL-capable Starlink satellites in orbit
Ground stations worldwide	~ 123	~ 25
Gateways deployed	~ 4,000	~ 200
Phased-array antenna cost (CPE)	\$100	~\$1,500 (estimate)
Satellite success rate	100%	~ 98%+
Number of satellites to launch	> 4,000	FCC rulemaking on orbital collision probabilities still TBD — may limit to < 4,000 total satellites

SOURCE: CSC Internal Estimates / Public Statements / "Starlink failures highlight space sustainability concerns," July 2019



Aircraft IFC Opportunity

In-Flight Connectivity

1,390 tails in service as of Q2-2021

Additional aircraft under contract:
~900 ☒ approaching 2,000 milestone

Promising growth opportunities with
new and existing customers

Hybrid Ku/Ka-band terminal introduced
for **wide-body aircraft market** ☒
expanding reach into airlines with long-
term Ku contracts

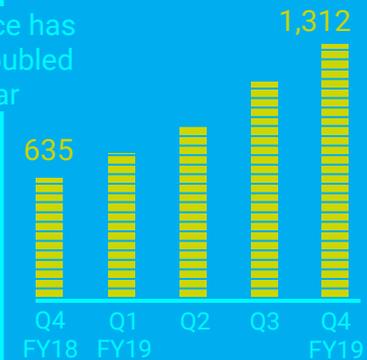
Wide-body Opportunity
9,180



SOURCE: Global wide-body fleet by year 2037 (Boeing 2018 - 2037 Commercial Market Outlook).

TAILS IN SERVICE

Tails in service has
more than doubled
Year-over-Year



Government Systems

Secure Connection

Embedded within an encrypted military network infrastructure

Best-in-Class

Nearly sole-sourced on several large encryption network contracts

Trusted Quality

Multi-decade long high-end performance for all branches of military

Continuous Development

Expanding addressable markets & new products and services drive growth

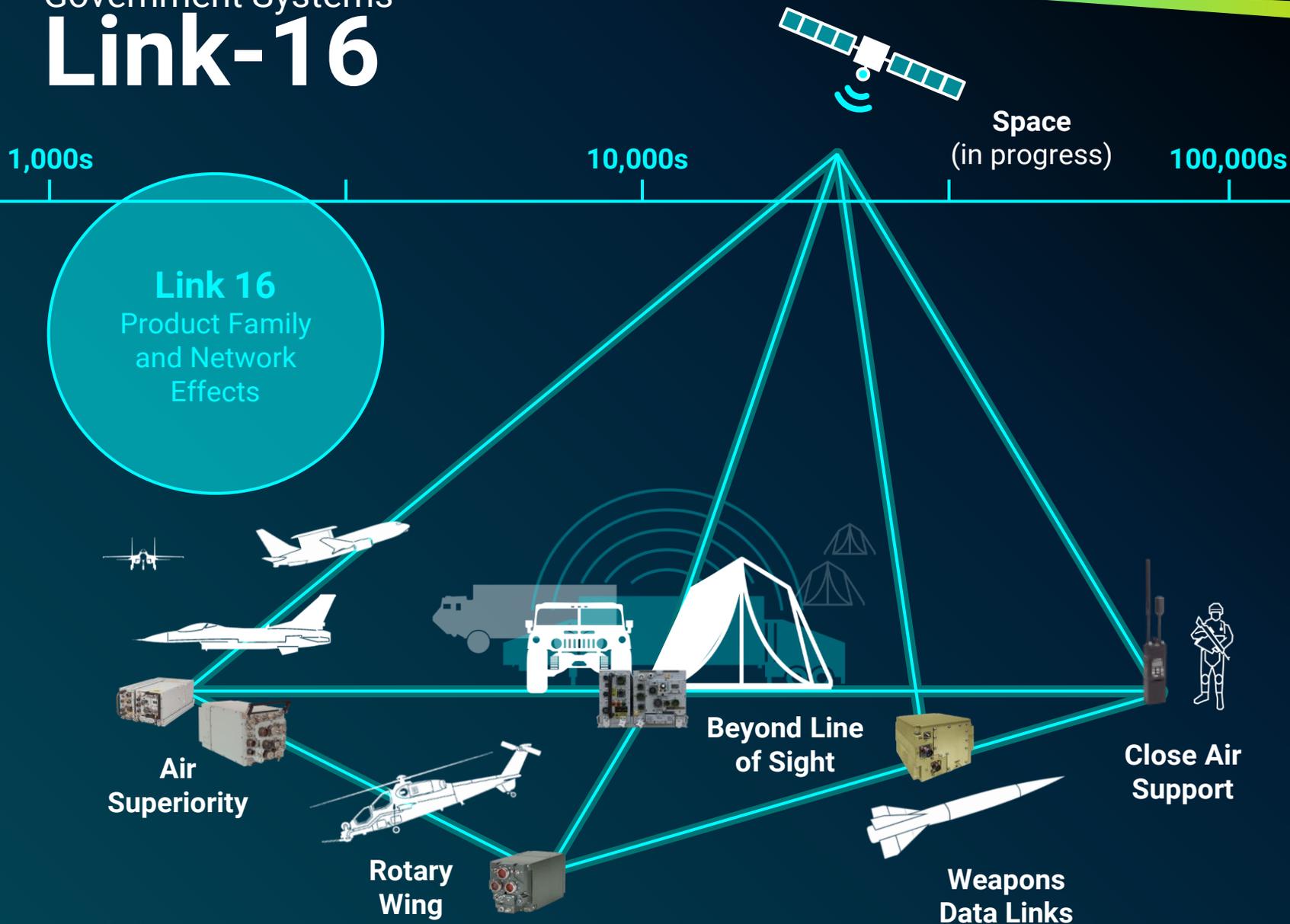
Space is the Limit

Exciting space systems opportunities

Elite Partnerships

Multiple IDIQ contracts + AMSS contract options represent ~\$1B opportunity

Government Systems — Link-16



SOURCE: Viasat

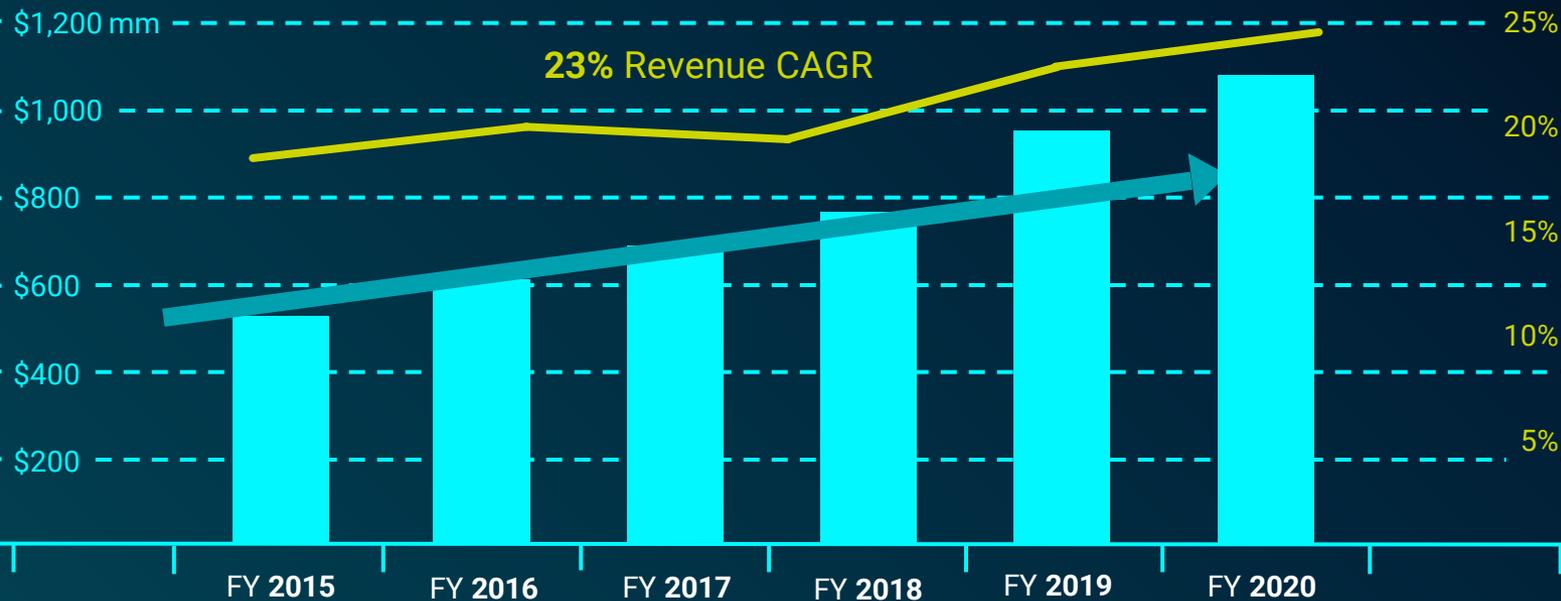
Government Systems —

Defense Business

Growth has been robust, backlogs have increased, and margins have continued to march higher

This business unit is a **Tier-1 Asset** for any major prime contractor

■ Defense Revenue ■ EBITDA Margin — %



SOURCE: Viasat

Sum of the Parts | Defense — Valuation

Separating out the Defense segment reveals an **immensely undervalued stock**



We estimate the **Defense** value from comparable companies

The closest defense competitor is L3Harris — however, Viasat's defense margins and growth profile more closely resemble FLIR Systems'

Taking the average of the 4 names below, we arrive at a public valuation of roughly **14x EBITDA** as of Jan 2021. To be conservative, we use 80% of that number.

	Price	Mkt Cap	EV	EV / Revenue	EV / EBITDA	P / E	Op Margin	EBITDA Margin	CAPEX % REV (3-Yr)
L3Harris Technologies, Inc.	184.24	38,478	44,929	2.4x	12.6x	15.8x	13.2%	18.7%	1.6
General Dynamics Corporation	150.78	43,251	56,573	1.5x	11.2x	13.7x	11.3%	13.5%	2.6
FLIR Systems, Inc.**	54.30	7,105	7,619	4.0x	18.4x	23.4x	17.6%	22.8%	2.7
Raytheon Company	67.69	102,735	128,897	2.0x	14.0x	22.2x	8.9%	14.6%	2.9
Average				2.5x	14.1x	18.8x	12.8%	17.4%	2.4%

SOURCES: CSC Internal Estimates / Public Statements

**FLIR being acquired by Teledyne (TDY)

Sum of the Parts | Satcom — Valuation

Taking the **DEFENSE** segment as a standalone entity, the value for the rest of the business—**COMMERCIAL HARDWARE** + **CONNECTIVITY**—implies a value less than \$0.26 on each dollar invested in ViaSat-1, 2, and the three Generation 3 satellites to be launched

Government Systems — Price/Share	\$ 46.00
Government Systems — Enterprise Value	\$ 3,200
Total EV	\$ 4,525
Implied EV of Satellite Connectivity + Commercial Hardware	\$ 1,325
Estimated Total CAPEX on ViaSat 1 / 2 / 3 through Jan 2021	\$ (5,100)
Implied \$ returned per \$ invested in Commercial Satellites	\$ 0.26

SOURCES: CSC Internal Estimates / Public Statements

Valuation

We value the company as a Sum of the Parts exercise:

Defense Segment

Split out from remaining business

Value derived via comparable transactions & public comps

Commercial Satcom

Satellites analyzed on an NPV basis

Model assumes V-1, 2, and 3 all exceed their WACC hurdle rates

Commercial Networks

Hardware group valued at zero

Provides R&D to both Defense and Commercial Satcom

Government price/share	\$ 46.00
CAPEX recover/share	\$ 73.91
NPV for V-3 Constellation, ex-military	\$ 9.55
Less expected net debt/share, ex-Satellite buildout debt	\$ (3.39)
Value per share:	\$ 126.07

Myths and Misperceptions

Myth #1: Low earth orbit (LEO) satellites will limit the US broadband opportunity for VSAT

- *CSC Contrarian Perception:*
 - Total addressable market (TAM) large enough for multiple players to be successful
 - This is not Google Search—not a winner-take-all market
 - No SINGLE winner in fixed broadband: Verizon, Comcast, Charter, AT&T, etc.
 - Lowest cost per bit will win and VSAT 3 will be VERY competitive on that basis
 - New applications will emerge that will help increase the TAM
 - Latency is only important for certain uses and can be reduced by hybrid network

Myth #2: VSAT's success is tied to how it competes in US rural broadband

- *CSC Contrarian Perception:*
 - In 3-to-5 years, VSAT will be known as a defense company first and an in-flight-connectivity (IFC) company second
 - VSAT Trojan horses (such as Link 16) will lead to military connectivity contracts when the birds are in the air
 - VSAT will help the US DOD enter a new world of real-time connected warfare
 - Meaningful Transpacific and Transatlantic IFC opportunity opens up with VSAT 3 satellites
 - ESG: VSAT is already connecting the world—Brazil, Mexico, & many more to come

Myths and Misperceptions

Myth #3: VSAT is an “old” tech company that is going to be disrupted by newer players

- *CSC Contrarian Perception:*
 - VSAT is **the disruptor** in the GEO space—compare capacity and proposed speeds to those of Hughes, Inmarsat, or anyone else
 - If VSAT can just take share from legacy GEOs and DSL → HUGE TAM

Myth #4: Elon Musk is so spectacular that Starlink will achieve things previously thought to be unimaginable

- *CSC Contrarian Perception:*
 - Consider base case: all other prior LEO companies (incl. OneWeb) = bankrupt; Google’s Loon = shut down; Amazon’s Kuiper = lots of filings but no development; Telesat = plenty of filings but no action
 - Physics still apply; connectivity does not exhibit network & scale effects like a social network— more new users → WORSE service for the existing users
 - Cost of launching/replacing LEOs is enormous and there is not ROI math that will ever work
 - There are not enough government subsidies available to support money losing broadband endeavors
 - Regulators may not continue to ignore space junk/collision risk and limit # of LEOs
 - But, Musk and Starlink currently winning the hype and PR battle

Key Variables —

Risk + Uncertainty

SHORT-TERM / COVID-RELATED



Consumer Activity — No flights due to virus = limited in-flight revenue = ~\$80mm of variable revenue at risk

Airline Health — No new plane installs due to airline financial woes

Government Operations — Decline in military spend due to delays in RFPs

Satellite
Success



LONG-TERM / EXISTING

Favorable
Conditions

Team
Performance

Satellite Risk — Asset is orbiting 22,500 miles in space— a risk that cannot be mitigated

Launch Risk — Binary satellite launch risks, timing and success of generation 3 constellation

Capacity Risk — Expected compounding results from successful satellite performance

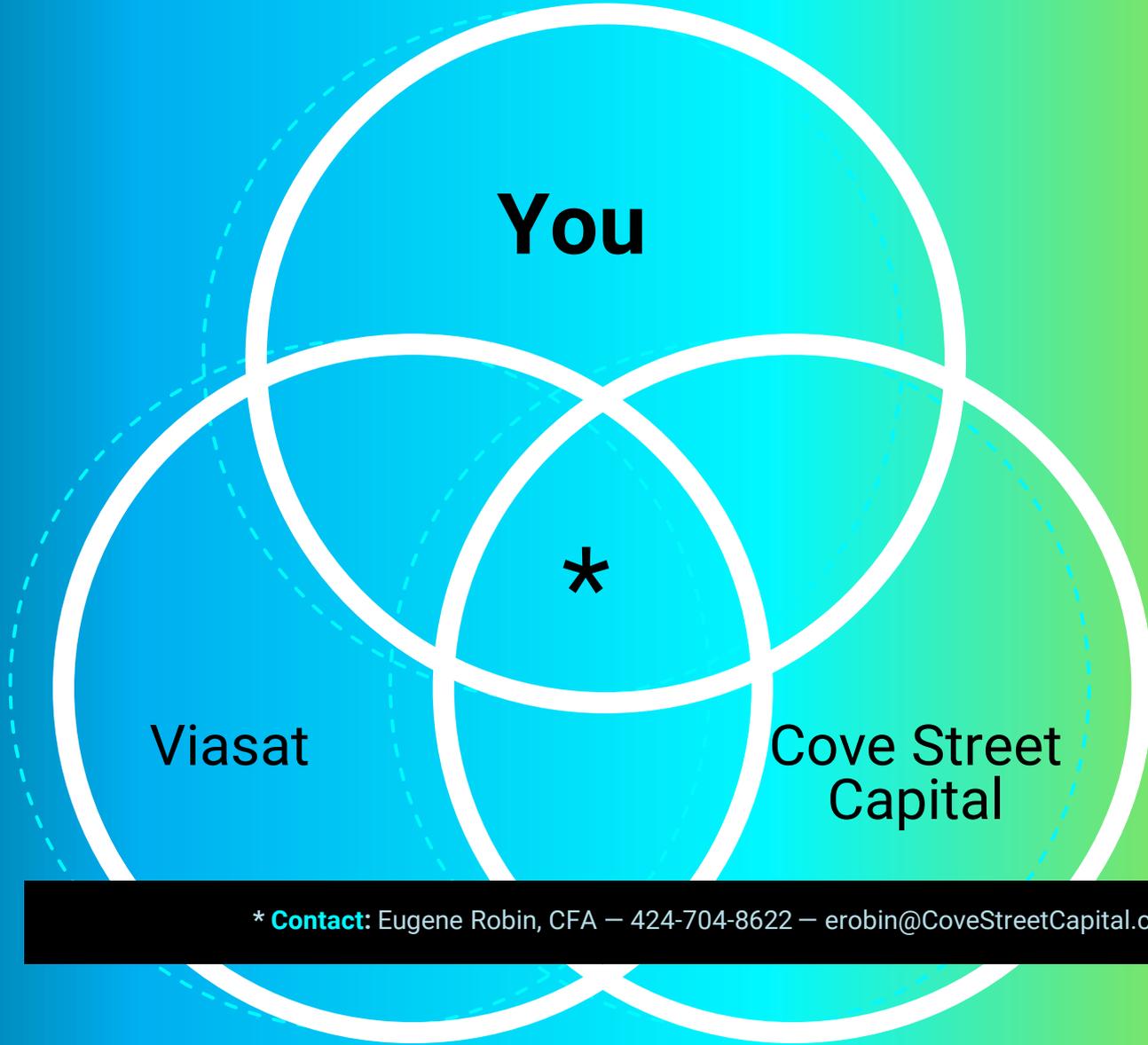
5G Backhaul Risk — 5G / Wireless high speed internet extension into rural / non-urban / underserved areas

LEO / New Competition — Low-Earth orbit constellations driving down pricing per bit faster than expected — Starlink from SpaceX, Kuiper from Amazon, Telesat, and OneWeb from SoftBank

Defense Budget — Future allocation to modernization initiatives

Public Activity — Engineering -focused team with little sensitivity to or interest in the perception of its value from the outside

Future Development — Internal technological advancement versus competitive developments



You

Viasat

**Cove Street
Capital**

* **Contact:** Eugene Robin, CFA – 424-704-8622 – erobin@CoveStreetCapital.com

APPENDIX

People + Pedigree

Prominent Heritage

Emerged from the San Diego Tech Cradle — Linkabit roots

Durable Offering

Multi-decade presence in defense encryption and connectivity solutions

Disruptive Innovation

Evolution from 100% defense to global commercial solutions

Trusted Business

Government Systems

Satellite Services

Commercial Networks

Defense / Military / Security / Home / Business / Air

Proven Quality

Superior Performance

Pedal to the Metal on Cost per bit delivered advantages versus incumbent satellite providers

Future Connection

ViaSat-1 to ViaSat-3 constellation efficiency gains of 8x in less than four years!

Unrivaled Assets

Unique Intellectual Property portfolio that has brought in >\$400 million

Elite Partnerships

The preferred choice for ground network infrastructure used by U.S. military and allies, all powered by Viasat IP

Link-16 Network

Network effects built on core Link-16 functionality create an enviable position of strength through which these future network connectivity solutions will be sold

Complete Ground-to-Air Network

designed by, optimized for, and implemented through Viasat



BATS-D handhelds



KG family of inline network encryptors



MIDS-JTRS terminals embedded in advanced weapon platforms — F-18, F-15, F-16, E-2D, B-2, C-130, etc



Mobile SATCOM via Ku/Ka hybrid **phased array antenna** used for ISR



SATCOM terminals for executive gov. aircraft (i.e. Air Force One)



HAIZE Type 1 encryption enabled — a unique Viasat encryption algorithm



STT KOR-24A terminals in helicopters and ground vehicles



BATS-E embeddable comms for weapons, targeting pods and UAVs

Competitor Cost Per Bit Delivered

LEO Hype vs. Reality



LEO competitors are riding a wave of hype, yet the cost reality is quite different:

	Telesat LEO	OneWeb MEO	SpaceX LEO	ViaSat-3 GEO
Number of Satellites	117	650	4,425	3
Max Theoretical Capacity (Tbps)	2.66	1.41	23.7 * ~9	3
# of Ground Stations Needed	42	71	123	V-2 reused
Gateway Antennas	221	725	3,690	N/A
Satellite Efficiency	58.8%	21.7%	25.1%	100%
Estimated Constellation Cost	\$3,000	\$4,338	\$8,854	\$2,700
Cost per Bit Delivered (Gbps)	\$1.13	\$3.08	\$0.37 * \$0.98	<u><u>\$0.90</u></u>

* **SpaceX comes with a caveat:** Maximum theoretical capacity is based on the assumption that they deploy an ISL; however all 955 Starlink satellites launched have lacked the functionality. Without ISL, max capacity drops to ~9 Tbps, arriving at \$0.98mm/bit—**leaving Viasat with the slight edge.**

SOURCE: CSC Internal Estimates / Public Statements / Portillo, Cameron and Crawley, 2019, "A Technical Comparison of Three Low Earth Orbit Satellite Constellation Systems to Provide Global Broadband"