Cove Street Capital

Further Adventures in Contrarian Value Investing

March 2022

Viasat

MILLICOM
THE DIGITAL LIFESTYLE

tigo

Safe Harbor

COVE STREET CAPITAL

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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

- Reminder who we are
- Updated thoughts on Viasat (ticker: VSAT)
- A brief overview of Millicom (ticker: TIGO)
- Q&A

Presenter

Ben Claremon

- Ben Claremon joined Cove Street in 2011 and has been a Co-Portfolio Manager for the Classic Value | Small Cap PLUS strategy since its inception in 2016. His background includes positions on the long and short side of hedge funds as well as commercial real estate finance and management. Ben is the proprietor of the value investing blog The Inoculated Investor, the founder of the 10-K Club of Southern California, and the host of the podcast Compounders: The Anatomy of a Multibagger.

Cove Street Capital

- Cove Street Capital ("CSC") is an LA-based, SEC-registered investment adviser founded in 2011
  - 100% employee owned
  - ~$600 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?

Viasat, Inc. Ticker: **VSAT**

An Irregular Path Upwards

Viasat

Best Idea –

Viasat

Price/Share:	$47
CSC Value:	$70 to $75**

This is arguably one of the most compelling investment opportunities in our firm's history and is **still** 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 almost worth the current stock price, implying little—if any—value for the remaining business lines.

**With a path to $100+ per share over time as Viasat-3 satellites launch

An Eventful Last Year

April 2021: Closed the acquisition of RigNet (Ticker: RNET) for $222mm in an all-stock transaction

- Provides VSAT access to a customer base in marine and offshore oil & gas to sell its connectivity services to, especially as Viasat-3 satellites are launched

November 2021: Announced the intention to acquire Inmarsat for $7.3B (based on the stock price the day of the announcement)

- Assumption of $3.1B in debt; $850mm cash payment, 46.36mm VSAT shares
- Inmarsat's private equity owners to own 37.5% of VSAT
- Combination will create one of largest satellite broadband companies in the world
- Company will have a leading position in in-flight WIFI, given Inmarsat's extensive customer base

February 2022: Due to COVID-related supply chain issues, the launch of Viasat-3 North America delayed until late summer of 2022

- Viasat-3 EMEA to launch 6 months later; APAC satellite after that

Inmarsat + Viasat = ?

The Reality of the Situation:

- For sure the announced deal was a surprise to industry participants, VSAT investors and the stock market as a whole
- Deal muddied a very clean story: launch long-awaited satellites, wait for a return in in-flight WIFI demand and generate cash
- Regulatory approval process taking a while and still has hurdles

What to Like:

- Deal accelerates Viasat's international growth by providing access to Inmarsat's existing customers and distribution partners
- While people thought that Inmarsat was shrinking, recent results suggest otherwise
- Substantial synergies, especially when it comes to Inmarsat's CAPEX
- L-Band spectrum complementary to Viasat's Ka spectrum
- Viasat-3 technology over night makes Inmarsat a better competitor
- Free cash flow **per share** projected to be 35-40% higher post deal
- Reduces relative exposure to consumer broadband (competition with Starlink)

Inmarsat + Viasat = ?

What Not to Like:

- Equity dilution (even though the deal valuation was based on a $67 VSAT stock price versus $47 today)
- Regulatory risk
- Execution/integration risk
- Management distraction risk
- History of "transformational" deals not panning out for the buyer

Implications of Russia-Ukraine Conflict

Initial Thoughts/Reactions:

- Members of the EU and NATO will have to start spending on defense after years of not doing so
- The connectivity capabilities of Viasat-3 EMEA will be critical to the US's allies in Europe
- Attacking satellite broadband infrastructure—either through cyber attacks or disabling physical infrastructure—likely to be part of 21st century war playbook
- Even companies known for encryption, such as Viasat, can be hurt by cyber attacks (residential versus encrypted military connectivity equipment)
- Putting ground stations in or near potential hostile areas is going to be a non-starter (sorry LEOs)
- Communications infrastructure proving to be critical to this kind of warfare (see Viasat's JTRS offering)
- Not incorporating any of this potential growth/demand in our models or projections

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 **15x EBITDA** as of Jan 2021. To be conservative, we use 85% of that number.

	Price	Mkt Cap	EV	EV / Revenue	EV / EBITDA	P / E	Op Margin	EBITDA Margin	CAPEX % REV (3-Yr)
L3Harris Technologies, Inc.	250.11	48,286	55,389	3.2x	14.5x	18.4x	15.0%	20.4%	2.0
General Dynamics Corporation	233.83	64,810	76,382	1.9x	14.8x	19.4x	11.4%	13.7%	2.2
FLIR Systems, Inc.**			8,000	4.1x	17.1x	23.8x	18.6%	23.5%	2.9
Raytheon Technology Corp.	97.04	144,117	171,469	2.5x	13.7x	20.2x	10.6%	17.7%	3.0
			Average	**2.9x**	**15.0x**	**20.4x**	**13.9%**	**18.8%**	**2.5%**

SOURCES: CSC Internal Estimates / Public Statements
**FLIR acquired by Teledyne (TDY)

Sum of the Parts | Consolidated

Valuation

We value the company *today* using a **Sum of the Parts:**

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

Low value for hardware group given R&D is buried in this segment

Provides R&D to both Defense and Commercial Satcom

Inmarsat Acquisition

Valued at the purchase price

Assumes that VSAT cannot improve upon Inmarsat meaningfully over time

Segment		Aggregate Value (mm)		Value Per Share
Satellite Service		$2,276		$19
Commercial Systems		517		4
Government		4,415		36
Inmarsat Purchase Price		7,300		60
Less: Current Debt + Inmarsat Cash Payment & Assumed Debt		(6,013)		(50)
TOTAL VALUE		$ 8,495		$70

SOURCES: CSC Internal Estimates / Public Statements

Another Way to Value VSAT: a DCF

Satellites lend themselves to a DCF analysis

- Big upfront spend and then a series of cash flows over 20-ish years
- DCF is probably the best way to capture the value VSAT is adding
- Individual assumptions can bias the results but a DCF is cleaner than what is essentially a hypothetical SOTP analysis (SOTP note: 3 year out value a lot more than $70/share)
- Using an 8.8% WACC and about 8.1% NOPAT growth from years 5 to 10
- Gets you a present value of $75 today
- The impossible thing to model at the moment is the 1+1 = 3 aspect of combining Inmarsat and Viasat
- Our research suggests investors are paying nothing at the current price for the potential revenue synergies, cross-sell opportunities and Viasat being able to access Inmarsat's customer base

Key Variables

Risk + Uncertainty

SHORT-TERM / COVID-RELATED

Consumer Activity – Fewer flights due to virus = limited in-flight revenue

Airline Health – No new plane installs due to airline financial woes; $100 oil doesn't help either

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

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

Inmarsat Deal Risk – See aforementioned laundry list of risk factors

Another Idea –
Millicom

Price/Share: $23.81
CSC Value: $58

The recent past has been quite painful but the current valuation and growth trajectory present a compelling opportunity for people willing to do the work right now

Cove Street Capital and its Principals have owned TIGO for a number of years

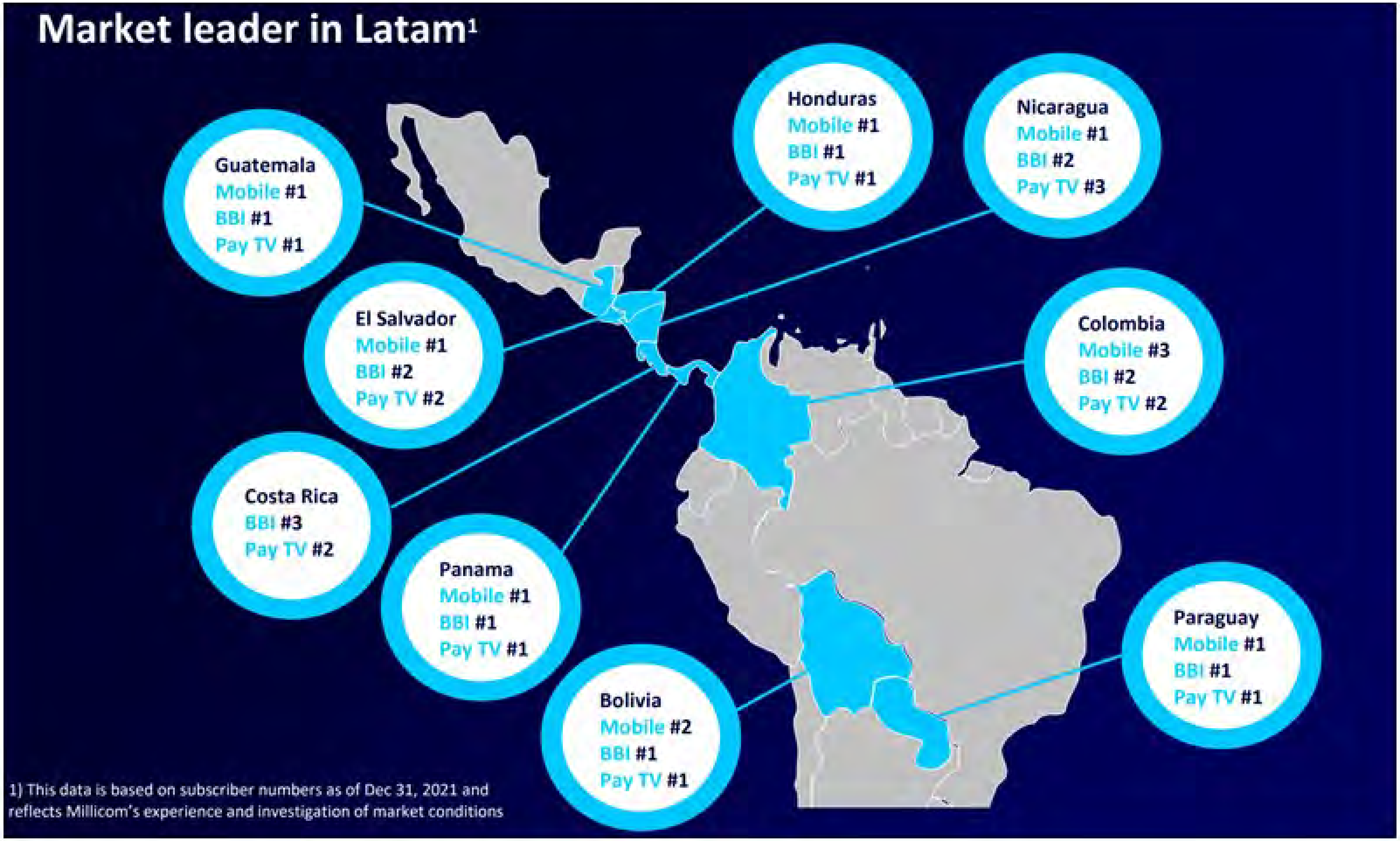
The market underappreciates the quality of management team and how the CEO, Mauricio Ramos, is running the John Malone cable playbook in Latin America

Millicom bought out its JV partner in Guatemala for $2.2B in November 2021. Unfortunately, the company needs to raise equity to lower the debt profile and this has created a huge overhang on the stock.

The company laid out impressive but credible growth targets (10% OCF growth) at a recent analyst day, plus announced its intent to explore monetizing tower and payments assets

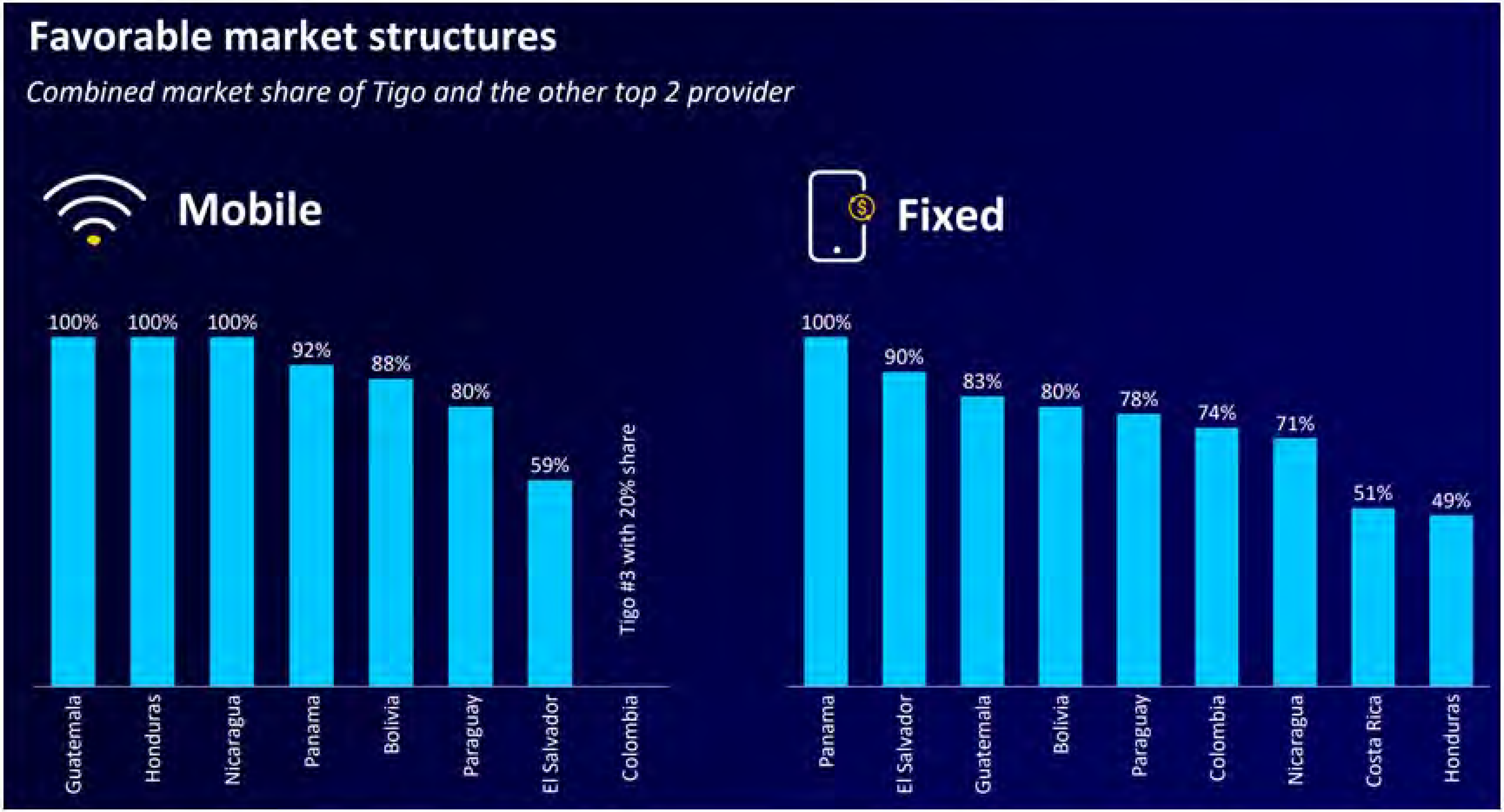
What is Millicom?

- **Leading wireless and cable company in Latin and South America**



What is Millicom?

- **Operates in growing, consolidated markets**



A Tough Few Years

2019: 37.2% holder Kinnevik distributes all of its shares to its investors

- Created an overhang on the stock and established a Swedish shareholder base that might not really care about LatAm cable and wireless

2020: The year of COVID

- Lockdowns in TIGO's markets were quite severe
- EBITDA and free cash flow negatively impacted

2021: A solid year of recovery

- TIGO invested heavily in wireless spectrum & new homes passed for its cable business
- Saw a nice rebound in its revenue and EBITDA

November 2021: TIGO agrees to acquire the 45% of its Guatemalan business it did not control

- 50%+ EBITDA margins, growing, generates solid FCF
- Simplifies the reporting structure (smaller non-consolidated line)
- Attractive 6.2x EBITDA multiple
- BUT: need to raise equity via rights offering to get to ~3x leverage

What's to Like?

No in-market competitors spending like TIGO is to pass homes in cable

- The company will become less wireless-dependent and more cable-exposed as the company adds subscribers
- Cable companies trade for higher multiples

Broadband and 4G Wireless penetrations in TIGO's markets are much lower than in developed markets

- Room to grow as these countries develop further and populations grow

The overhang of the right offering has crushed the stock but existing shareholders will have the ability to maintain their % position

- Stock has fallen from ~$35 when the accretive, no-brainer Guatemala deal was announced to under $24 today
- Valuation, which was already cheap, has become distressed: under 4x NTM EBITDA

Management is focused on finding ways to create shareholder value

- Continuing to invest in spectrum and broadband infrastructure
- Monetizing tower assets and Tigo Money payments business

TIGO Valuation

Current Valuation: $23.81/share

- Market cap: $2.4B
- Enterprise Value: $10.5B

DCF Value: $58

- Assumes ~21mm shares issued in rights offering
- 9.5% WACC; 4% NOPAT growth after year 5

Multiples Analysis: $57

- Based on $2.36B in EBITDA in 2024 and a 6x multiple
- 8x cable multiple + 5x wireless multiple --> 6.4x W.A. multiple
- $51 core value plus ~$6/share for the Honduras JV stake
- Assumes no excess value for towers or Tigo Money

Risks and Short Points

- Equity dilution that comes with a rights offering (have to participate to maintain your % stake)
- Ongoing currency risk
- Emerging market country risk
- Leverage profile
- Further M&A risk
- TIGO will never trade at a higher multiple because of the markets it is in

Resources

Compounders Podcast:

- https://compounders.podbean.com/

Recent interviews with VSAT's Executive Chairman Mark Dankberg:

- https://covestreetcapital.com/creating-the-fastest-global-satellite-broadband-network-with-mark-dankberg-executive-chairman-of-viasat-inc/
- https://covestreetcapital.com/viasat-mark-dankberg/

Recent interview with TIGO's CEO Mauricio Ramos:

- https://covestreetcapital.com/millicom-ceo-mauricio-ramos/

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Q&A