

Avanti Communications

More favourable debt terms

The company has announced a further positive financing development with the securing of \$100m of Super Senior Debt with a coupon of 7.5% that provides a significant reduction in interest payable on around 10% of outstanding gross debt. The recent trading updates are less positive and we have reduced our expectations accordingly. In addition, we still await a launch date for HYLAS 4 which is a crucial factor in attaining the required revenue and cash flow development. The fair value for the equity falls to 93p from 109p previously with our longer-term assumptions unaltered.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
06/15	85.2	(73.3)	(61.4)	0.0	N/A	N/A
06/16	82.8	(67.0)	(49.3)	0.0	N/A	N/A
06/17e	62.0	(108.3)	(70.2)	0.0	N/A	N/A
06/18e	92.0	(130.1)	(79.9)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Super Senior Debt issue a positive sign

The \$100m 7.5% Super Senior Debt line has been secured from HPS Investment Partners, who have \$39bn of assets under management, and this is a positive for Avanti. Not only is a notable investor showing confidence in the model, but the terms also provide a significant interest saving on 10% of the outstanding gross debt. As previously, we assume all the available payments in kind (PIKs) are enacted which will take gross debt to almost \$1bn. Improved terms for existing bondholders to compensate for the loss of seniority will offset this to a degree, but the liquidity provided will further underpin Avanti as it prepares for the major capacity addition that should be provided by HYLAS 4. We now expect a launch around the turn of the year although a final date has yet to be confirmed.

Trading remained difficult through H2

The Q3 trading statement showed continued weak revenue development and this persisted in Q4 despite a modest sequential improvement. We believe this was due to customer uncertainty during the refinancing which should now unwind. The order intake of c \$50m in H217 is encouraging, although the outcome for FY17 means revenue momentum into FY18 is below expectations. The additional liquidity provided by the debt facility and the deferral of the covenant calculation alleviate the immediate pressures. Given no date has yet been announced for the launch of the HYLAS 4 satellite, which we now expect to be delivered to the company in Q118, we have delayed revenue generation to reflect later commissioning.

Valuation: Decline reflects near-term shortfall

The reduction in near-term expectations leads us to reduce our fair value calculation for the equity, and the value remains sensitive to levels of revenue attainment both to the upside and the downside. It currently stands at 93p but remains highly geared to performance. Greater clarity should be afforded by contributions from the large HYLAS 4 capacity when it finally comes on stream.

Additional financing secured and trading update

Fixed satellite services

18 July 2017

Price **9.05p**

Market cap **£15m**

US\$£=1.30

Net debt (\$m) at 31 March 2017 751.1

Shares in issue 162.1m

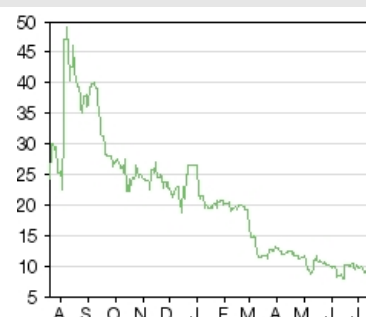
Free float 100%

Code AVN

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (10.0) (26.9) (67.7)

Rel (local) (9.2) (27.5) (71.2)

52-week high/low 49.0p 7.8p

Business description

Avanti Communications is a London-based fixed satellite services provider. It sells satellite data communications services to service providers in its key markets of enterprise, broadband, carrier services and government. It has Ka-band capacity on four satellites, with two launches due in 2017.

Next events

Preliminary results September 2017

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Positive debt finance secured

Avanti has secured a \$100m line of 7.5% Super Senior Debt from HPS investment Partners maturing in 2020. The debt will replace the \$50m tranche of delayed PIK Toggle Notes due for issue and add \$50m of additional liquidity, more than compensating for weaker than anticipated trading in the current half year.

While the coupon on the debt of 7.5% represents a significant and very welcome reduction on the existing bonds, some of the terms on the issued notes have been revised in the bondholders' favour. The new debt represents around 10% of the face value of the gross debt that is expected to be in issue when all of the PIK tranches have been made. In addition, the date of the initial covenant calculation has been deferred to March 2018 from June 2017, relieving the immediate concern caused by weaker current trading than we had expected.

Weak trading has persisted, but order flow is improving

Q3 results announced on 31 May 2017 showed no progress, with uncertainty pending the strategic review and refinancing in H117 persisting amongst customers. As confirmed in the pre-close statement, the weak trading has continued in the final quarter, with a modest sequential revenue improvement to c \$17m.

One encouraging sign has been a pick-up in order intake in recent months with almost \$50m of new orders signed since April. Recent contract wins have been varied in size and scope but we highlight the major recent announcements below:

- A contract for an undisclosed customer in the mobility market to fill gaps in network coverage and support peak demand. The mobility market covers satellite connectivity for ships, aircraft and land transportation and is normally provided by specialist service providers. It now forms Avanti's fifth focus vertical market.
- A contract from the European Regional Development Fund (ERDF) to supply rural broadband access to small businesses across Cornwall with speeds of up to 40Mbps, worth up to £1.2m.
- Lead on an €8.3m research and innovation contract to integrate satcom as an intrinsic part of 5G networks, including the provision of live demonstration testbeds in the UK, Germany and Finland. The project's 16 partners include leading global businesses such as Thales Alenia Space, Airbus Defence and Space, SES and BT.
- A new \$21m three-year contract to supply services to an existing government customer in Africa.

We would expect order intake in FY18 to return to a more normal flow of contracts through the year, with the potential to accelerate as HYLAS 4 enters service.

While the sales run rate picked up in the final quarter, Avanti exits the current year with a reduced sales momentum, which has ramifications for FY18 sales. In addition, as the timing of the HYLAS 4 launch has yet to be announced, we assume this will be later than previously expected. The satellite is due for delivery shortly, and a launch in early 2019 looks increasingly likely. We have reduced our FY18 forecast accordingly. With the largely fixed cost base, the EBITDA declines and cash flow performances reflect this lower outcome very directly, although once again we do expect stronger progression once HYLAS 4 is commissioned.

Exhibit 1: Revisions to estimates

Year to June	Sales (\$m)			EBITDA(\$m)			Net debt (\$m)		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
2017e	84.2	62.0	-26	12.3	(11.1)	N/M	746.2	756.1	+1
2018e	127.4	92.0	-28	67.6	12.8	-81	905.6	971.6	+7

Source: Edison Investment Research estimates

Reduction in near-term cash generation

Our DCF-based fair value calculation decline reflects the worse than expected near-term performances. The value is highly geared to the revenue generation of the company as the drop through to operational cash flow is very high. In this regard FY18 should prove to be a better indicator of the progress of the model compared to the highly disrupted FY17. However, it will be FY19 before we see the first full year contribution of the HYLAS 4 potential. Until then, now that the debt lines are secured, the focus will be to fill all of the satellite capacities and we await progress on this front. The risks to both the upside and the downside remain, and are highly sensitive to performance.

At present we have maintained our long-term assumptions and expectations in our DCF calculation, including the elimination of HYLAS 1 and 2 contributions from the terminal value. Our adjusted DCF model now returns an equity value of 93p, and the sensitivity to terminal growth rates and WACC is reflected in the table below.

Exhibit 2: Adjusted DCF calculation sensitivity to WACC and terminal growth

WACC	8%	9%	10%	11%	12%	13%	14%	15%
Terminal growth rate								
0%	237	186	140	98	61	27	-4	-33
1%	278	218	166	119	78	41	7	-23
2%	333	260	198	145	99	58	21	-11
3%	410	315	240	177	124	78	38	2
4%	526	393	295	218	155	102	57	18

Source: Edison Investment Research estimates

While our fair value is multiples of the current share price this reflects the current market concerns as to whether Avanti can execute on its strategy, and that with such a large debt burden the risk that the equity could be crushed if it does not. Management success in delivering the planned cash flows should be a crucial factor in alleviating the worries and reducing the discount. We would point out that we have maintained relatively cautious assumptions with respect to HYLAS 4 fill rates, once commissioned, as well as on the existing satellite fleet. In these circumstances the fair value remains sensitive to both the upside and the downside not just on WACC and terminal growth expectations, but also to cash generation levels achieved.

Exhibit 3: Financial summary

	\$m	2014	2015	2016	2017e	2018e
Year end 30 June		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		65.6	85.2	82.8	62.0	92.0
Cost of Sales		(86.7)	(83.8)	(86.0)	(88.6)	(90.7)
Gross Profit		(21.1)	1.4	(3.2)	(26.6)	1.3
EBITDA		(7.7)	12.5	4.6	(11.1)	12.8
Operating Profit (before amort. and except.)		(53.9)	(32.6)	(39.8)	(55.8)	(34.1)
Intangible Amortisation		(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Exceptionals		5.3	0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0
Operating Profit		(48.7)	(32.8)	(40.0)	(56.0)	(34.3)
Net Interest		(38.9)	(40.5)	(27.0)	(52.3)	(95.8)
Profit Before Tax (norm)		(93.0)	(73.3)	(67.0)	(108.3)	(130.1)
Profit Before Tax (FRS 3)		(87.7)	(73.3)	(67.0)	(108.3)	(130.1)
Tax		0.0	0.0	(2.2)	0.0	0.0
Profit After Tax (norm)		(92.0)	(73.3)	(69.2)	(108.3)	(130.1)
Profit After Tax (FRS 3)		(87.7)	(73.3)	(69.2)	(108.3)	(130.1)
Average Number of Shares Outstanding (m)		107.4	119.0	139.4	153.5	162.1
EPS - normalised (c)		(85.2)	(61.4)	(49.3)	(70.2)	(79.9)
EPS - normalised fully diluted (c)		(85.2)	(61.4)	(49.3)	(70.2)	(79.9)
EPS - (IFRS) (c)		(81.2)	(61.4)	(49.3)	(70.2)	(79.9)
Dividend per share (c)		0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		-32.1	1.6	-3.9	-42.9	1.4
EBITDA Margin (%)		-11.7	14.7	5.6	-17.9	13.9
Operating Margin (before GW and except.) (%)		-82.1	-38.2	-48.1	-90.1	-37.0
BALANCE SHEET						
Fixed Assets		645.9	721.5	804.5	851.5	932.5
Intangible Assets		14.0	11.0	10.8	10.6	10.4
Tangible Assets		610.9	691.0	775.1	822.3	903.5
Investments		21.1	19.5	18.6	18.6	18.6
Current Assets		235.7	160.3	137.8	87.6	65.4
Stocks		1.7	2.6	1.9	1.4	1.9
Debtors		21.0	17.8	39.3	27.9	28.9
Cash		195.3	122.2	56.4	33.2	10.0
Other		17.6	17.7	40.2	25.2	24.6
Current Liabilities		(44.4)	(36.6)	(86.1)	(43.9)	(40.5)
Creditors		(39.9)	(31.9)	(82.8)	(43.9)	(40.5)
Short term borrowings		(4.5)	(4.7)	(3.3)	0.0	0.0
Long Term Liabilities		(527.7)	(540.5)	(654.7)	(802.0)	(994.4)
Long term borrowings		(512.4)	(523.7)	(642.0)	(789.3)	(981.7)
Other long term liabilities		(15.3)	(16.8)	(12.7)	(12.7)	(12.7)
Net Assets		309.4	304.7	201.5	93.2	(36.9)
CASH FLOW						
Operating Cash Flow		5.1	(8.1)	(22.7)	(9.0)	25.9
Net Interest		(39.0)	(54.4)	(67.4)	(32.5)	(28.0)
Tax		0.0	0.0	(2.2)	0.0	0.0
Capex		(25.8)	(102.0)	(95.7)	(66.9)	(119.6)
Acquisitions/disposals		0.0	0.0	0.0	0.0	0.0
Financing		(7.6)	80.0	5.3	(58.8)	(93.9)
Dividends		0.0	0.0	0.0	0.0	0.0
Net Cash Flow		(67.3)	(84.5)	(182.7)	(167.2)	(215.5)
Opening net debt/(cash)		254.4	321.7	406.2	588.9	756.1
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0
Other		(0.0)	0.0	0.0	0.0	(0.0)
Closing net debt/(cash)		321.7	406.2	588.9	756.1	971.6

Source: Company reports; Edison Investment Research estimates

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