Select African telecoms operators go local

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Had the $23 billion Bharti Airtel-MTN cash-and-share-swap merger gone ahead – thus creating the third biggest mobile operator in the world in terms of subscriber numbers – 2009 would have been a record year for sub-Saharan Africa telecoms debt financing volume, with over $4.5 billion of loans lined up to support the MTN side of the deal alone.

Although the merger failed at the end of September, the deal is an example of both international bank appetite and domestic lending capacity for African telecoms deals: When the merger was shelved banks were finalising a club deal in which $2 billion of locally denominated debt was to be raised via Rand Merchant Bank, ABSA, Nedbank and Investec, and a further $2.5 billion was to come from international lenders via MTN's advisers Bank of America Merrill Lynch and Deutsche Bank.

The pace of African telecoms growth, and lender appetite for it, has been the investment success story of the past decade. According to a recent report by UNCTAD, the number of African mobile subscriptions surged from 54 million to almost 350 million between 2003 and 2008 – an increase of close to 550%. In 2008, the average penetration stood at just over 33% for Africa as a whole. In 2009, Informa predicts a 26.6% year on year increase in mobile growth, with the total number of active subscriptions to exceed 473 million by year-end.

Growth is expected to remain robust. Five African countries – Burundi, Djibouti, Eritrea, Ethiopia, and Somalia – still have a mobile penetration of less than 10% and according to telecoms investment fund Altimo, the average mobile penetration rate across the whole of Africa will exceed 50% by 2012. Informa is also bullish, predicting total active subscriptions to increase to approximately 800 million by 2014, by which time SIM penetration across Africa should reach 70%.

The statistics don't say it all

The figures are impressive but potentially misleading in terms of risk evaluation for lenders. The market is highly competitive and fast-moving, which can impact on operators meeting schedules for predicted ramp-up profitability. Cell C, South Africa's third mobile operator, raised a $530 million project finance facility via Citi, ABSA, Investec, Nedbank, and ECAs and development banks, in 2003. However, the operator took a long time to get profitable and the lenders were repaid by a junk bond.

More recently, the global liquidity crunch has finally impacted the market and some operators are struggling with higher debt pricing – up by around 150bp for telecoms project debt, although now beginning to drop a little. For example Zain Africa has been the subject of sell-off speculation all year and recently posted a net profit drop of 53% year on year for Q3 in 2009. The reason for Zain's problems, as stated by chief executive Saad Al Barrak are: "The global economic crisis, unfavourable foreign currency fluctuations, particularly in many of our African operations, coupled with reduced interest income and investment income plus higher financing costs, have had a significant impact on the company's overall profit."

Consequently, more deals are looking for and need multilateral, ECA or development bank support. The IFC has been particularly active in the region with deals this year for Helios Towers Nigeria and Zain Ghana, neither of which could have been financed in the commercial bank market alone.

Neotel

Nevertheless, selective deals have made it into the commercial project finance market. In March Neotel reached official financial close on its R4.4 billion ($589 million) project finance facility – the largest limited recourse financing of a greenfield telecommunication transaction yet completed in the South African market – and more recently, MTN Uganda closed an innovative ongoing bank debt programme based on project finance and MTN note principles.

Neotel's R4.4 billion project debt was lead arranged by Nedbank Capital, Investec and Development Bank of Southern Africa, with the Industrial Development Corporation and the Infrastructure Finance Corporation as participating lenders. The deal largely concluded a two-year programme to raise long term debt and equity funding – which now totals R7.5 billion – and replace all R2 billion of Neotel's existing bridging facilities.

The debt comprises a senior facility of R3.1 billion for 7.5 years with quarterly repayment period; a second lien facility of R200 million for 9.5 years with quarterly repayment period provided by commercial banks; a second lien facility of R800 million for 9.5 years with quarterly repayment period provided by development banks; and a 10-year R300 million mezzanine facility provided by the Infrastructure Finance Corporation at a relatively low interest rate but with a guaranteed return and an equity kicker.

The deal is effectively a war chest as Neotel, which has already spent around R2 billion on its infrastructure roll-out, takes on Telkom for market share. Neotel plans to invest a further R1.5 billion to R2 billion in infrastructure roll-out in the next two years and will spend between R10 billion and R11 billion in total on infrastructure roll-out, with generated revenues expected to provide the balance of the funding. Neotel is also the SA landing partner for SEACOM (Africa's major new undersea fibre optic cable), which will provide greater access to broadband.

The negotiations to financial close on Neotel demonstrate the extent to which the local debt market, which was still relatively benign in 2008, has changed.

It took some time for the effect of the credit crunch to hit the South African bank market, with Standard Bank, because of its international presence, being the first to adjust lending rates followed by the major domestic lenders ABSA, Investec and Rand Merchant.

Consequently, when Neotel's lead arrangers first attempted to firm up pricing in June 2008 the sponsor balked at an extra 100bp over its initial expectations and opted to let the market decide. The result was even higher than the 100bp. Both Rand and Standard Bank were interested, but only at the right price, and ABSA was overexposed to the telecoms sector.

Eventually a club deal was put in place with a minimal sell-down to KfW/DEG and State Bank of India, post financial close. Despite the debt pricing being higher than Neotel's shareholders originally expected to pay, consensus now is that Neotel got a good deal.

MTN Uganda

The other, and more recent, significant project-type deal in the sub-Saharan telecoms market in the past year is the 'medium-term loan program' for MTN Uganda, closed in October.

The deal is a first for the region – an ongoing funding program that enables MTN Uganda to borrow up to $150 million ($100 million of which was issued in the initial syndication) on a senior secured basis at any point in time.

Lead arranged by Absa Capital (also global-coordinator), Barclays Bank of Kenya, Barclays Bank of Uganda, KCB Bank Uganda, Stanbic Bank Uganda and Standard Chartered Bank Uganda, the initial $100 million equivalent facilities are split between a UGX118.8 billion ($60 million) five-year local currency term loan, a $20 million five-year term loan and a UGX39.6 billion five-year revolving credit.

Financings of this type are normally done on a senior secured basis in the sub-Saharan market, typically in the form of a floating charge over all of the assets of the borrower (excluding the telecommunication licence due to regulatory and legal constraints). The borrower is therefore unable to secure additional financing as it becomes available, despite having the cash flows and the credit profile to support additional debt without refinancing the existing debt to release the existing security. This results in the unnecessary additional costs of a complete refinancing, in terms of security registration on the whole amount, as well as costs, upfront fees and other out of pocket expenses that are incurred every time the borrower refinances.

Conversely, under the MTN Uganda structure the terms of the financings – initial and future (up to $150 million) – are set in a common terms agreement, with an accession mechanism allowing other facilities to accede to these common terms and become part of the same syndicate. Any new lenders will have to sign a short facility agreement, setting out mainly the commercial terms, while all the credit and other major terms have already been included in the common terms agreement – similar to a pricing supplement in the case of a bond issue. As the facilities are repaid, the borrower can continue to issue more debt under the program by entering into these facility agreements (to the extent the total debt amount outstanding does not exceed $150 million).

Because a key driver of structure is the minimisation of security re-registration costs, each financing under the program has its own security (a floating charge over all of the assets of the borrower excluding the telecoms licence). However, each group of lenders is also required to accede to the intercreditor agreement which ensures that all the secured lenders rank pari passu – in effect the intercreditor agreement equalises the different debentures (all of which have the same agreed form) obtained and registered at different points in time, thus ensuring that all the creditors end up ranking *pari passu.*

Consequently, and in addition to removing the need to release existing security and incur a cost on reregistering it as part of the refinancing process, the borrower does not have to put in place a security of $150 million upfront, only a security up to the amount issued under the program – the costs savings are thus significant.

The deal adopts European leveraged finance documentation standards to manage the relationship between various creditors that might be providing facilities to MTN Uganda in the future, as well as multiple security arrangements that results from the granting of additional facilities under the program. It is the first time that the new LMA recommended form of intercreditor agreement for leveraged finance transactions has been used in the context of syndicated loans in sub-Saharan Africa.

The intercreditor arrangements also allow MTN Uganda to enter into hedging transactions on a secured and pari passu basis with debt providers, thus enabling it to hedge against currency and interest rate fluctuations when the opportunity arises.

In addition to the structural innovation, the deal adopted a two phase syndication strategy and, in the second phase, brought in commitments from Bank of Africa Uganda; Citibank Uganda; DFCU Bank; Ecobank Uganda; Orient Bank and United Bank for Africa Uganda at the general syndication stage. East African Development Bank, Housing Finance Bank, and Bank of Baroda Uganda are also in the process of joining the syndicate post financial close.

Going forward

It is difficult to draw conclusions from the transaction flow in sub-Saharan telecoms – the deal flow has been too small. Beyond Neotel and MTN Uganda, the only other financings in 2009 are all corporate: Vodacom Tanzania with a $60 million Citi-led five-year deal (the second tranche of a $150 million facility, the first $90 million of which was raised in 2008 and priced around 200bp); MTN Côte d'Ivoire raised a Cfr76 billion ($150 million) loan in March and Kenya's Safaricom signed a $63 million bridge in April and is looking to take out that deal with a bond.

However, there is consensus that at some point in the coming year the telecoms M&A market will almost certainly pick up – Zain has stated that its African assets are not for sale but it must remain a contender for a merger given its recent results. Furthermore, while the market is difficult to predict, and some deals must have access to multilateral funding to get done, the local bank markets are demonstrating growing ability to provide both finance and innovation, whether that be in the nature, risk aware South African market or other emerging sub-Saharan markets. And while telecoms deals continue to find growing liquidity locally, sponsors can offset the headache and cost of foreign exchange hedging.