Memory men

01/10/2003

It has happened in Asia, just as in other global telecoms markets: oversupply of fiber optic cable, unrealistic growth projections for data traffic and a collapse in the economics of the submarine cable sector. But this is one of the few black marks against the Asian telecoms and media industry. Compared with European telecoms and media, debt levels are low, user growth rates are strong and banks have been left wishing there were more deals around.

While the process of restructuring sub-sea cable project financings is still ongoing, one painful but crucial lesson has had to be learnt, says bankers: that sponsor support for project deals often isn't worth the paper it is written on. "A lot of telco sponsors gave assurances that they would support their project finance transactions in order to get lower pricing," explains the banker, "and partly because of these assurances, banks entered into some deals which they would not otherwise have entered."

When the fiber-optic projects started to go sour, many of these assurances failed to materialize. "As a result bank credit committees tend to be less impressed by details of board backing and sponsor support,"says Steve Weiss, head of telecom & media finance at ABN Amro in Hong Kong.

Financiers say that Singapore Telecom signed a contract obligating it to provide cash-deficiency support for the C2C sub-sea cable project (in which SingTel has a 59.5% stake) if revenues fell below forecast. "But the company has taken the decision to force a restructuring of the original financing rather than have to provide ongoing financial support to the project," says one observer. In all likelihood creditors will be forced to write-off a significant chunk of the loan in the restructuring process or see a portion of the outstanding debt converted into equity.

Following legal advice, SingTel cancelled its commitment to C2C under a convertible loan agreement that supported the project's $660 million secured bank debt facility. A spokesman for the company says SingTel's lawyers have advised that the telco is no longer obligated to extend the balance amount of the $164 million loan to C2C ($36 million of the original convertible loan had been drawn). In response, lenders have issued a notice to SingTel calling upon it to disburse to C2C the $164 million. The banks also informed C2C that an event of default under the facilities agreement has occurred and they were therefore converting the floating charge relating to C2C's project financing into a fixed charge in relation to the convertible loan agreement

"The question now is whether banks will collectively take a tough stance against SingTel, possibly through the courts," asks another banker. Lead arrangers of the debt financing for C2C were Citigroup, Bayerische Landesbank, Industrial Commercial Bank of China and Sumitomo Mitsui Banking Corporation, which wrapped up syndication in December 2001. None of these names were prepared to reveal what action they will now take.

SingTel apparently still views C2C as an important asset and is prepared to consider committing additional funds to C2C provided that a restructuring plan can be agreed on. But could SingTel's tough line with lenders back fire on the company longer term? Mickey Mehta, head of telecoms finance at Banca Intesa in Hong Kong, thinks not. "Bankers have budget targets to meet which results in selective memories." Other sponsors of failing telecoms and media projects have walked away from their contractual commitments and suffered few consequences as a result.

The Carlyle Group, for instance, had agreed to support a Won 340 billion loan acquisition financing for a company it had invested in: Korea's Mercury Corporation. The financing, put together back in 2000, allowed Mercury's purchase of Daewoo Telecom's transmission, optic fiber and switching businesses. Mercury was subsequently unable to meet debt service commitments on the loan as demand forecasts for fiber optic usage turn out to be impossibly optimistic. Bankers say that Carlyle walked away from its commitments to the financing which then had to be restructured. But this has not stopped the US investor from tapping the bank markets again in a refinancing deal for another of its Asian investments, cable TV operator, Taiwan Broadband. "In fact," says one industry source, "because the investment has performed a lot better than expected, the refinancing will be a significantly better priced for the sponsor and the structure a lot more borrower friendly."

According to a source close to the restructuring negotiations, Mercury's debt service obligations have been suspended for nine months until the first quarter of 2004. Thereafter the maturity profile remains unchanged. "That means banks have accepted some refinancing risk in 2007, when the loan reached maturity," the source says.

If banks are more wary about sponsor commitments to project finance transactions, the unfortunate history of recent project deals in the sector is also discouraging telcos from further non-recourse financings. "The C2C financing was the only structured deal in SingTel's portfolio," reveals a banker in Hong Kong, "and we hear they now regret doing a deal on that basis." If true, this new attitude will, of course make little difference in the short term, SingTel confirms to Project Finance that it has no financing requirement for the rest of this year.

"The growing reluctance to mandate project financings has also arisen because equity analysts now consolidate off balance sheet projects into a company's balance sheet, reducing the rationale for mandating a non-recourse deal," says Weiss.

Refinancings have accounted for much of the recent deal flow in the Asian telecoms market and have helped the shift away from project finance. Several deals have been concluded where non-recourse transactions have been turned into corporate deals. June's HK$3.8 billion term loan for Hutchison Whampoa arranged by Agricultural Bank of China, BayernLB, BNP Paribas, China Construction Bank, Standard Chartered and SMBC is a prime example. Proceeds are being used to refinance the HK$4.4 billion project facility for Hutchison Global Crossing which closed in September 2001.

Project finance opportunities in the Asian telecoms sector have also diminished with the increasing maturation of the industry. "As the telecoms infrastructure in the region has developed, the need for project financing has reduced," says Joseph Lim, vice president structured finance at Credit Agricole Indosuez in Hong Kong. With core infrastructure now in place, players have been able to cut back on capital expenditure. "Instead companies are girding up for the next round of spending which will come with 3G," says Tom Fuller, responsible for telecoms finance at Citibank in Hong Kong.

Although bankers may regret the project finance lull, Fuller thinks the broad trend is a healthy one. "A good number of telcos in the region who might once have been considered project finance risks are now cash flow positive partly because of the more restrained levels of capital expenditure." Lim agrees, "indeed the average net debt of the Asian cellular industry at large is now close to zero with many borrowers having repaid and in some instances pre-paid their loans. Borrowings are increasingly raised through corporate loans and bonds."

Mehta says that non-recourse deals will still happen in markets where penetration rates are low and relatively small operators have the opportunity to expand. "The Indian mobile business is a good example - we are just now starting to see the sorts of year on year growth rates in Indian mobile telephony that people were expecting six or seven years ago," he says. But while the Indian telecoms arena may provide a few project finance opportunities for international banks, Mehta believes most project finance debt for smaller operators will be provided by the local banks. "And the big players like Tata will probably opt for corporate style deals," he says.

Outside India, one project finance deal which was being considered until recently was for Thai mobile operator, TA Orange. However, following an internal board restructuring, the company has put its long-term financing on the back burner, says a banker. The deal, which was to be arranged by ABN Amro and SG, would have been a refinancing of an existing bridge facility. A Coface-guaranteed portion was considered for the deal, but given liquidity in the local bank sector, any near term financing is likely to be an almost entirely a Thai affair.

Ironically, the slowdown in activity has come at a time when banking interest in the telecoms sector is picking up. Almost across the board in telecoms and media (with the exception of fiber optic cable deals) banking appetite has strengthened.

"Two things have happened that have helped this trend," says Weiss, "first international banks have succeeded in getting their credit committees to distinguish between the Asian telecoms industry and the industry in Europe and the Americas, and secondly, banks believe the telecoms market has bottomed out on a global basis anyway."

Perhaps partly for these reasons, SG has just established a media and telecoms finance team in the region. Thierry Magnan, the new head of the team, based in Hong Kong, says, "it makes sense for us to come in when there is a lull in the market. It gives us time to build up our market presence, and we do believe in the medium term that there is a lot of investment still to be made in Asia."

But when will this new spending spree occur? According to Rosalie Nelson, research director, telecoms, at market research and consultancy firm, Ovum, there will only be limited spending on 3G projects in Asia in the next few years. "Early roll-out will be thin (occurring mostly in concentrated urban or business districts) and will often be done just so that 3G license holders can meet certain minimum requirements of holding those licenses," she says. Only in a few countries (Singapore and South Korea for instance) is 3G roll-out required by law within a specific time frame.

Nelson does not describe this next round of investment as anything like a spending spree, "more like measured, judicious investment," she says, adding, "much of the focus in mature Asian markets will be on increasing uptake of services not new capex." EDGE technology which increases capacity on existing mobile networks may also take some of the wind out of the 3G sail. "It will offer some smaller players the chance to upgrade and offer 3G-like services but at lower cost. Some companies in the Philippines and Hong Kong are looking to adopt the technology," says Nelson.

Bankers are increasingly looking to Indonesia as well as India for future opportunities in the mobile sector. "We've seen the mobile subscriber base in Indonesia rise very fast in recent years, from 2.2 million in 1999 to 7.8 million in 2002. But in every market one needs to be able to assess the penetration ceiling to know how far the market can grow," says Nelson. In mature Asian markets, like Hong Kong, Australia and Taiwan, saturation typically occurs at penetration levels of 70% to 90%. "But in a market like the Philippines affordability will continue to be a constraint and the penetration ceiling is realistically, therefore, much lower. This will also be the case with Indonesia," says the research director.

But other segments of the telecoms and media business will still provide financing opportunities and of late, much of the focus has been on the media/cable-TV sector. However, most cable-TV opportunities have been in East Asia, notably Japan and Taiwan. Few other countries have bankable cable-TV businesses. Following the March closure of the ¥140 billion ($1.2 billion) transaction for Japan's Jupiter Telecommunications (arranged by Bank of America, Citibank Tokyo, Bank of Tokyo-Mitsubishi, Mizuho Corporate Bank and Sumitomo Mitsui), financiers do not see further TV-related deals in Japan in the near term.

And while Taiwan has been the source of several project finance cable TV deals, the market is not enormous. Mehta at Banca Intesa does not believe other cable-TV markets are easily banked. "The Hong Kong market is small and it has taken a long time for the one operator there to even get to 600,000 subscribers. New competition is being introduced but the market can't really support another player," he says. In India, on the other hand, the potential market is very large indeed. "But there are too many too small players," says Mehta, "and there are problems concerning the payment arrangements for cable-TV services: often payment is in cash and not put directly into accounts which banks can get security over."