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Crash course

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The collapse in value of telecoms companies over the last couple of years has been particularly acute among the third generation UMTS mobile licence holders in Europe. The huge sums bid for these licences when they were auctioned off at the end of the 1990s set alarm bells ringing almost immediately over the financial health of the licencees ? concerns that have proved to be well-founded. Caught up in the problem are many sponsors involved in project financings put together in a time of high optimism and which now find themselves in a very different business environment. ?The deals that were closed in 2000 would not be closed now,? muses David Bugge, managing director of telecom finance at Deutsche Bank in London.

The problems facing the sponsors of some of these deals have been thrown into sharp relief by the fate of one of them: Mobilcom. Mobilcom was one of six bidders to be successful in the auction of UMTS licences in Germany in August 2000. The other five licencees were Group 3G, T-Mobil, Mannesmann, E-Plus Hutchison and Viag Interkom. Each licence cost around Eu8.4 billion. Mobilcom is 28.5% owned by France Telecom and has been embroiled in a bitter row with its owners over its expansion plans. Mobilcom founder Gerhard Schmid has come to blows with France Telecom over the amount the French company is prepared to invest in its German venture. France Telecom invested Eu3.74 billion in Mobilcom in 2000 but the cost of setting up its UMTS network has been put at around DM25 billion (Eu13 billion).

Schmid owns 39% of the company ? a stake that he has been trying to persuade France Telecom to buy. Central to this dispute is Mobilcom's debt pile: the company signed a Eu4.7 billion bridge facility to enable it to finance the UMTS licence and is now saddled with a total debt figure approaching Eu7 billion. In 2001 it generated a loss before interest and tax of Eu237 million. Its losses for the first quarter of this year far outstripped analysts' forecasts at Eu120.7 million (Eu34.8 million in 2001) and the gloom was compounded by the fact that revenues have also fallen from Eu728.7 million last year to Eu514.3 million for the same period this year as Deutsche Telekom and Vodaphone have cut their commission payments to the operator. Network commissions accounted for 40% of Mobilcom's revenues last year, but this year they account for just 13%.

The last thing France Telecom wants is to take a larger stake in Mobilcom, given that it is trying to deleverage its own balance sheet in order to maintain its credit rating. The French telecoms company is already burdened with Eu61 billion debt thanks to acquisitions such as Mobilcom and Italian 3G joint venture Wind (which has now been sold to dominant venture partner Enel).?Any move by France Telecom to increase its stake in Mobilcom would amplify its business and financial risks and penalise credit quality,? says Peter Kernan at rating agency Standard and Poor's in London. But the row between the two companies has developed into such an acrimonious feud that many see the only way forward as for France Telecom to buy Schmid out. According to Schmid, under German takeover law France Telecom is required to make a full bid for the company at a price of 22 euros per share.

A proposal has been made whereby France Telecom might buy Schmid out but a consortium of banks would hold on to the stock until such time as the company could manage Mobilcom's debt on its own balance sheet. But amongst all this wrangling another problem has become very apparent: the bridge facility signed by Mobilcom matures in July this year and the pressure is now on for it to be refinanced. The deal was arranged by ABN Amro, Deutsche Bank, Merrill Lynch and SG and syndicated to BNP Paribas, Chase, Dresdner Kleinwort Wasserstein (then Benson), ING, Sumitomo Bank and

WestLB. It expires in July, by which time a refinancing agreement must be in place to avoid bankruptcy at Mobilcom.

Developments at Mobilcom over the last two years are exactly the kind of scenario that lenders to UMTS project financings dread. Some have pointed to the company's problems as a warning to the entire market but others are not quite so pessimistic. ?Mobilcom should be differentiated from the rest of the market because of its ownership structure,? explains Jack Peck, head of telecoms finance at IntesaBci in London. ?It is a unique situation.? IntesaBci has been active in the 3G market, co-arranging the $2.6 billion Amena UMTS network rollout deal signed in Spain at the end of 2001 and the Eu4.2 billion H3G network build out deal in Italy, which signed in March this year. Peck remains optimistic about the rest of the market. ?The risks haven't changed from when these deals were done,? he says. ?If anything the 3G market in Europe is slightly more certain.?

But that does not detract from the fact that companies are now trying to refinance deals in market conditions that are almost the direct reverse of what they were just two years ago when the deals were put together. ?Market conditions will definitely impact on the refinancings,? says one industry executive at Citibank in London. ?The refinancings are hugely dependent on support from the sponsors.? And with sponsors in the kind of financial difficulty that Mobilcom faces it is not a pretty picture.

The Mobilcom scenario highlights the markedly different situations that project financings done as term deals and those done as bridge deals face. When the 3G licences were auctioned in 2000 many of the project financings put in place were bridge deals. But the market is now clearly split between those that have already been structured as longer-term fully amortising transactions and those that have not. The most high-profile examples of projects that are funded long-term are the E-Plus, Wind, H3G Italia, Amena and Connect Austria deals.

E-Plus Mobilfunk (majority owned by KPN) is Germany's third largest mobile operator and was awarded a German UMTS licence along with Mobilcom in August 2000. The purchase was part-financed via a Eu2.5 billion seven-year deal signed at the end of 2001 structured as a Eu2.25 billion term loan and a Eu250 million revolving credit. Arrangers were Citibank, Deutsche Bank and JP Morgan Chase. Connect Austria was done as an eight-year deal again split between a term loan (Eu620 million) and a revolver (Eu70 million). That deal was co-arranged by a group of five banks including JP Morgan, WestLB, Hypobank, Dresdner Bank, RBS and BNP Paribas. The deal was signed at the beginning of November 2001 and actually took out a Eu545 million bridge deal that was signed in 1998 ? prior to the auction of the 3G licences.

Given the deterioration in market value of many of these 3G project sponsors it would appear that deals that were sewn up for seven to eight years by the end of 2001 are in a better position than those like Mobilcom that are now looking to refinance. ?If there is a lesson that can be learned from the whole 3G experience it is that of going back to a fully-funded business plan,? states the Citibank executive. ?These companies were taking a huge risk buying time at the peak of the market,? he tells Project Finance. The higher profile bridge-financed deals include Mobilcom and Hutchison Group's £3.6 billion three-year deal signed in March 2001.

Those close to the Mobilcom refinancing talks indicate that the four lead creditor banks are close to an agreement on how to restructure the company but a France Telecom spokesman commented as recently as May 28 that bankruptcy at Mobilcom was still ?a possibility?. Talks are understood to involve France Telecom issuing a convertible bond without maturity with a strike price at least double that of the company's current share price. That would enable France Telecom to keep Mobilcom going without adding its debts to its own balance sheet. The convertible would be treated as ?hybrid equity? by the rating agencies as it would rank below the company's other borrowings in the event of default.

Another part of the solution would be for some of the 13 banks that make up the syndicate of the Eu4.7 billion bridge deal to acquire Schmid's 39% stake together with his other family holdings, which in total amount to 50% of the company. It is most likely that five banks would acquire 10% each ? effectively getting France Telecom itself off the hook of buying Schmid out. While this restructuring is clearly not what the banks had in mind when they went into the Mobilcom deal, it is seen as preferable to the German company's collapse.

Given the controversy surrounding Mobilcom, it is difficult to gauge what exactly the appetite is among the lending banks for their continuing 3G exposure. Most participants agree that the terms on which the original deals were struck would not be the terms on which such deals would be struck today ? but by how much would they have deteriorated? ?These deals were revolutionary at the time,? says Peck at IntesaBci. He explains that they were looked at on a 10-year repayment profile but after liquidity performance analysis repayment profiles were cut back to shorter periods of three to four years with a view to refinancing. ?This was an honest assessment of the industry at the time,? he says.

But just because a deal is a bridge does not mean that it faces the problems that Mobilcom does. Hutchison's UK UMTS licence financing is in a far more favourable position than its German counterpart. Despite the obvious advantage that the sponsor does not face its own internal financial crisis, the Hutchison 3G Holdings loan was only signed in March 2001 and runs for three years ? thus refinancing will only become due in March 2004. The deal was structured as a £2.475 billion revolver and a £375 million term loan. The revolver incorporated a six-month term out option and a one-year term out option. After two and a half years (September next year) the borrower must also demonstrate that its business plan is fully funded to the three-year maturity and after three years that it is fully funded until the end of the extension period. The deal was co-arranged by JP Morgan, WestLB, ABN Amro, Merrill Lynch, HSBC, RBS and Citibank. ?The Hutchison deal is structured in a better way as they have been more successful in buying time,? notes the Citibank executive.

The issue of which deals may have been structured to better withstand the downturn is rather a moot point as most of these 3G loans were structured along very similar lines. ?All these deals were structured in the same way and driven by the same things,? says one telecoms expert. David Bugge at Deutsche Bank draws a distinction between financings for those sponsors that were looking to fund an extension of their 2G business and those that were looking at greenfield projects. The Mobilcom deal was effectively an extension of its 2G business as it had a three million subscriber base ? but as a virtual operator. In contrast, the Hutchison deal in the UK was a greenfield project. ?People were definitely looking at more conservative capital structures for the greenfield deals in 2000,? he says. ?It was down to the nature of the sponsors.?

But for all these transactions, the prospect of refinancing will have the banks weighing up the issues in perhaps a rather different manner than they were in 2000. ?These deals were originally done when 3G expectation was at its peak,? says the Citibank executive. ?Bank market appetite has definitely waned since then.? Bugge at Deutsche says that the banks will be looking at the corporate resources of the borrower and how much equity is coming in. ?A key issue is how much uncovered risk the banks will be prepared to take,? he says. ?The days of people being prepared to take substantial amounts of uncovered risk are over.? He notes that in most cases the bridge deals that were done were to fund licence payments. As such they were recognising future funding payments the economics of which may well now have changed.

The situation at Mobilcom has certainly cast a shadow over the whole 3G sector in Europe but financiers remain upbeat about its prospects going forward. ?No banks have lost money on these deals ? yet,? says one. ?This industry will not go the way of the cable industry,? one financier confidently predicts. ?The leverage is lower and it is less complex.?