Cell-ing locally

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The cellular revolution on the sub-Saharan continent is striking simply for its exponential growth. Investment in African cellular networks is bubbling despite a global telecom industry still staggering from its debt burden throughout most of the industrialized world. But there is more. Recently, several African deals have highlighted the urgency of bringing new instruments to bear on financing emerging market infrastructure projects ? most notably through credit enhanced local currency (CELC) debt.

The continent's telecoms sector is notoriously underdeveloped, though demand, especially for mobile technology, is vast. Nearly 30 million Africans now have mobile phones, up from 2 million four years ago, and this figure is expected to at least double in the next three years. As many developed markets around the world reach saturation, operators will increasingly start to look to relatively immature regions for fresh investment. And in Africa, going cellular is a cheaper and quicker alternative to developing fixed line infrastructure.

Market liberalization is underway and more transparent regulatory environments are finally clearing the ground for explosive growth, and, with it, the likely economic benefits that access to advanced communications can bring. And the major players like France Telecom, Vodafone (primarily through its Vodacom venture), and regionals such as South African M-Cell, through its ubiquitous subsidiary MTN, are setting about hungrily carving up the bigger markets.

CELC-ulating risk

The key to developing a competitive telecoms infrastructure across the continent is to secure the backing of international investors ? with a view, arguably, to incorporating untapped local financing where possible. ?In a lot of emerging markets there is no hedge for currency risk and a lot of people have been burned by carrying large amounts of foreign currency debt,? says IFC's Patrick Leahy, senior investment officer for telecoms and information technology.

Emerging markets sponsors with local currency revenues, of course, need long term financing in local currencies. With international investors feeling the pinch of emerging market currency risk, structuring a local element into a telecoms deal would seem like the sensible hedge against potential currency devaluation. This more innovative approach to financing deals across the continent (indeed, throughout emerging markets) is one driven by caution on the part of international investors. For Africa, this has meant the arrival of credit enhanced money ? through both local bank and capital markets ? with multilaterals, export credit agencies and commercial banks awakening to its efficacy.

But markets vary radically throughout the continent. As such, the applicability of local currency instruments, and the need for credit enhancement, will depend on disparate and specific domestic circumstances. Access to local capital markets to finance cellular deals will be constrained by the maturity of the market and its regulatory climate, the strength of the security package, as well as the appetite of local investors. But as a broader concept, local currency project financing is gaining new momentum ? especially for telecoms deals.

Kenya calling

One of the most conspicuous examples of this advance is last year's Safaricom deal in Kenya. It features the first ECA-backed local currency bond ever to have been issued. For Kenya, it is the largest non-governmental bond issue with the longest tenor to date in the history of the country's capital markets.

The $80 million (equivalent) deal finances Siemens equipment for Safaricom's GSM network roll-out. The latter is joint venture between Vodafone Kenya (40%) and Telkom Kenya (60%).

Citibank, as financial adviser to Safaricom, designed the deal's structure, which is most notable for its use of a credit enhanced local currency (CELC) bond.

Financing comprises Ksh4 billion ($51.1 million equivalent) in five year floating rate notes, and an Eu25 million six-year loan. Lead arranging the commercial loan are Citibank, Barclays, KBC and Standard Chartered. All are on the same ticket with a 125bp participation fee.

?We wanted to minimize exchange rate risk while maximizing funding in foreign income,? explains Safaricom's CFO Les Baille. ?We also wanted it done non-recourse to the shareholders.? Vodafone is typically prone to taking out non-recourse financings for its (and its subsidiaries') network buildouts. In this case, the operator had already chipped in over $40 million of its own equity to the deal and therefore wanted to minimize its exposure.

Before opting for Citbank's bond solution, however, Safaricom had evaluated several other financing alternatives. The original plan sought Siemens' vendor finance, although the contractor finally decided against it. Another solution put forward by Barclays called for a straightforward bank financing, with a substantial local component.

But, says Christopher Jackson, vice-president and co-head of global project finance for media and telecoms at Citibank, ?there was a need to tap a larger investor base of Kenyan shillings that simply wasn't available from the bank market alone.?

Citibank ultimately won the advisory mandate to structure the deal. It had already picked up relevant experience with local bond financing in Africa, having previously done two such issues (one being a modestly-sized medium term floating rate note issue for Kenya's ?Shelter Afrique?).

The Citibank solution put forth a strong package, which accounted for the actual depth of local investor appetite ? something which, according Baillie, may not have been immediately apparent. ?Aside from allowing us to access an alternative investor base, the bond issue really helped us maximize the local currency portion of the debt,? explains Jackson: 70% of the final package is in local currency, providing a comfortable hedge against currency risk.

Citibank NY provided a 75% guarantee on the notes, with the balance secured by a debenture over Safaricom assets. Citibank was in turn covered by a local currency denominated insurance policy, provided by Office National du Ducroire (OND), the Belgian ECA. The latter is providing 75% comprehensive cover for both facilities and a further 22.5% PRI for the term loan. The OND coverage insured Siemens ATEA's exports from Belgium.

The notes are also attractively priced at 100bp over the 91-day Kenyan Treasury Bill. They drew significant commitments from local investors ? 85% of the issue was committed prior to the retail distribution launch, which closed fully subscribed on 11 June 2001. Five major local investors, including otherwise inaccessible pension funds and insurance companies, committed to the issue. KSh proceeds are deposited into a KSh escrow account in Kenya and converted into Euros within 60 days, then deposited into a Euro escrow account in London.

The six year commercial loan is priced at 150bp above Euribor during the availability period, thereafter reducing to 125bp if debt service cover ratio (DSCR) is greater than 1.5x for two consecutive quarters. It returns to 150bp if DSCR is less than 1.5x.

?What we hadn't appreciated at first was just how radical this solution was to Kenya,? says Baillie. ?The issue was in fact twice as large as the previous one and has exerted a tremendous effect on the local capital markets.?

It is primarily for this reason that the Kenyan Central Bank (CB) stepped enthusiastically behind the deal. Indeed, the CB had been itself independently trying to develop a longer-term yield curve for the Kenyan Treasury bill. And the Safaricom issue provided the perfect opportunity. The government has since launched both 1 year and 2 year fixed rate T-bills, and is looking to issue a 3 year bill soon. The CB's Governor Nahashon Nyagah is said to be looking to pursue even a 15 year issue ? eventually.

In the end, the Safaricom structure and its success was driven by commercial considerations specific to Kenya ? there simply was a strong local appetite for a benchmark bond rather than a syndicated loan. The investment made sense to Kenyan investors hungry to diversify away from the standard 90-day T-bill with a stable, medium-term asset. Moreover, the Kenyan market has substantial excess liquidity. Bank deposit rates are low and there are few long term investment opportunities.

Giving credit

At the same time, the deal worked because of its support from Belgian ECA, OND. Indeed, the bond structure helped reduce OND's premium by mitigating convertibility and transferability risks. It also allowed the ECA commitment to be extended beyond its usual country limit.

Says Jackson, ?a number of multilaterals and export credit agencies are saying they'd like to come in and participate in a deal similar to what we did in Kenya. We're currently talking to a number of agencies and we've definitely seen a much greater level of interest, as awareness of the advantages spreads.?

Until Safaricom, local currency bonds had failed to captivate many ECAs, partly because of the high levels of commercial risk mitigation required by local bond investors. But the benefits of the CELC bond are apparent. According to Jackson, aside from excluding key risks from agency cover, the instrument can restrict covenants to the recourse agreement with the agency; it can outlive defaults, if credit enhancers' obligations are cash collateralised; it can reduce the need to disclose market sensitive information, depending on the extent of cover; and it can provide new liquidity options to increasingly sophisticated investors.

?Agencies and development banks are slowly coming around to the idea that they may be well served by guaranteeing local currency transactions, and not just offering hard currency deals. But raising local currency through partial guarantees is new to the commercial and investment banks as well,? says IFC's Patrick Leahy.

The IFC has noteworthy experience backing a local currency bond market telecoms deal in India. There, it provided partial credit guarantee for a Rs3 billion ($64 million) 10-year bond issued by Bharti Mobile, a local cellular operator, last year ? the first ever use of a partial risk guarantee on a bond issue.

?A lot of sponsors are saying they won't take currency risk anymore and indeed the whole market is changing. This product is not the same as a typical project finance loan where everyone understands the standard structures that need to be applied ? it needs to be much more highly customized from market to market,? cautions Leahy.

But it is precisely this market to market concern that raises the question of the CELC bond's applicability to other sub-Saharan telecoms deals. Credit enhanced local currency bank debt, on the other hand, is also demonstrating its utility (and originality) in other African telecoms deals.

Enhancing the scope

In Cameroon, the IFC and French development bank Proparco recently provided a joint credit enhancement facility ? comprising partial guarantees and a stand-by facility ? for a $45 million loan, arranged by SG. The facility backs a project financing for Societe Camerounaise de Mobiles (SCM, a subsidiary of France Telecom) to develop and operate a nationwide GSM cellular network in the country, and was finalized mid-February.

After Safaricom, this is one of the few African telecoms deals to have yet benefited from credit enhancement of local debt ? albeit in this case a loan facility. In fact, the structure is a first for the IFC, using both partial guarantees and a standby facility. Structured to maximize local currency liquidity, it encourages local and regional banks to participate in a long term project financing. It also increases the amount of local currency loan paper available, while extending its maturity.

The credit enhancement was supplemented by subordinated loans from Proparco and IFC for a total of Eu5 million. IFC and Proparco are each guaranteeing 12.5% of the project debt. Beyond this, they are supplying a standby facility for up to 25%, in order to reduce the capital weighting which would otherwise be allocated by local banks for a loan stretching to seven years (a problem given local capital weighting laws). Accordingly, banks are making provision for up to year five. The IFC and Proparco standby facility guarantees a refinancing option in the loans sixth and seventh year.

The credit enhancement facility was successfully syndicated by SG to a group of eight local commercial banks: Societe Generale de Banques au Cameroun, Banque Internationale dyu Cameroun pour l'Epargne et le Credit, Credit Lyonnais Cameroun, Standard Chartered Bank Cameroun, Comemrcal Bank of Cameroon, Afriland First Bank, Societe Generale de Banques en Guinee Equatorial, and Societe Generale Tchadienne de Banques.

The SCM transaction follows from last year's sizeable telecoms project financing for MTN Cameroon's Eu180 million limited recourse GSM deal. That project (Cameroon's first project financing) featured credit enhancement from both the African Development bank (ADB) and Dutch Development Agency FMO on a 5-year Eu35 million local tranche ? the first time either had provided credit enhancement for local currency debt. Citibank and Standard Bank arranged the 6-year Eu60 million international debt portion, which also pulled 100% political and 50% commercial cover from Swedish ECA EKN.

In both cases, local bond issues were simply not viable given the underdeveloped state of Cameroonian capital markets, emphasizing again the highly market-specific relevance of the CELC bond.

?We're in the field to develop local capital markets where possible so we don't typically guarantee 100% of a bond issue or bank loan because we want credit risk to be shared by local financial institutions,? says IFC's Leahy. ?Ultimately for a bond issue to work, there needs to be a sizeable enough local market with sufficiently sophisticated investors, and with a local rating agency capable of analyzing the deal. Where tis is not the case, we focus on working with local banks.?

Nigeria ? the big one

Nigeria is potentially Africa's largest cellular market, with an estimated population of 114 million. The government auctioned three GSM licences in January 2001 for $285 million apiece, in a process widely credited as encouragingly transparent. The two new major mobile operators (aside from incumbent Nitel), Econet and MTN, launched their networks in August last year. The latter expects its network to yield its highest continental returns.

In a landmark transaction, MTN Nigeria recently secured its debut local currency financing ? a N19.2 billion ($170 million equivalent) commercial paper facility sold on a club basis to 7 local banks. Underwriting the deal are Citibank Nigeria, Stanbic Bank Nigeria, Diamond Bank, First Securities Discount House, Investment Banking & Trust Co, Union Bank of Nigeria and Union Bank of Africa.

MTN favoured the local currency route, again to minimise its foreign exchange risks. The 12-month deal features a multi-layered pricing mechanism that ?enables banks to feel comfortable with the yield.? The deal, which finances the roll-out of Ericsson equipment, and MTN's general corporate needs, was signed on January 24.

The bridge loan, which closed recently, helps sets the stage for a more substantial project financing for MTN. ?They're going for either a local bank or bond financing,? says a source familiar with the deal, though financing is currently still in the exploratory stages. A credit enhancement, if needed, is likely to come from the IFC. Given Ericsson's presence, EKN backing is also likely to be sought.

The final deal could cost up to $1 billion, with up to $200 million in local currency credit enchancement. Says a banker familiar with the deal, ?MTN wants to maintain its expansionary push and a credit enhancement would give them a couple of years grace period. In that sense it would be very helpful.?

The CELC bond may yet remerge in the Nigerian market, given the Safaricom benchmark. Though having lost strength over the last year, the Nigerian capital markets are still described optimistically by some as being ?as robust as the strongest African markets; MTN should certainly keep all their options open?.

One of the advantages of a bond issue over bank debt is tenor ? possibly making longer-term money available. Says

Citibank's Jackson, who is advising MTN Nigeria, ?Safaricom could be replicated to an extent, but it will largely depend on the bank market. The fact that we just completed a very large and highly successful CP issue may create enough momentum for us not to need the bond option.?

Ultimately, in Nigeria as in other more developed African markets, there is a lot of pent-up demand from local investors. And, says Jackson, ?by providing structured solutions we're helping meet this demand.?

Citibank is also advising South Africa's latest mobile entrant, Cell-C (the country's third mobile operator), on the financing for its GSM rollout. The company (owned 60% by Saudi Arabia's Oger Telecom and 40% by CellSAf) aims to capture about 20% of South Africa's mobile customer base within the next 5 years.

Cell-C has already signed a non-recourse vendor financing bridge loan with contractor Siemens, split between rand-denominated and dollar funds.

The forthcoming project financing is likely to call for up to $650 million. The next phase will be to secure local shareholder financing for around $100 million. In addition, a long term ECA facility for between $175-200 million and a development bank portion of around $50 million will also contribute to the mix, possibly from DBSA. Credit enhancement could come from a combination of Citibank and Saudi support. ABSA and NEDCOR are also understood to be eyeing the deal.

Says one South African banker, ?there is certainly no constraint in getting it done here in terms of volume, but the question is whether the local banks have the appetite and whether South African banks take that credit risk.? He adds, ?the appetite for telecoms project debt in South Africa will lie with banks not currently exposed to MTN or Vodacom,? the country's two largest mobile operators. Cell-C's push to profitability might pose a challenge, in light of the highly competitive domestic market; but the company's financing strategy can only benefit from the depth of innovation brought to African telecoms deals over the last year.