Engaged or engaging?

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Hopes of a bonanza for Central and Eastern European governments selling Universal Mobile Telecommunication System licences received a blow in December, when the Polish government was forced to scrap its auction process because only three bidders came forward for the five licences on offer.

Instead, Poland will now simply add UMTS services to the licences of the three existing dominant players in the domestic mobile market, Centretel, PTC and Polkomtel, each of which will pay the Eu650 million fee that was originally set as the minimum level in the auction process.

The events in Poland will depress expectations in other countries such as Hungary and the Czech Republic, which plan to award UMTS licences during 2001. But for bankers the lower fees will come as a welcome surprise, since the very large licence fees and capital investments needed to get UMTS off the ground have made lending into the telecoms sector a much riskier proposition.

Even with the more advantageous outcome for the mobile companies in Poland, bankers still believe that the tight pricing enjoyed by the telcos during 1999 and 2000 will not be available in 2001, with lenders looking for wider margins to reflect the higher risks across the telecoms sector worldwide.

?There are too many banks and too few deals, and all the banks want the same prestigious deals,? comments one banker. ?The competition is cut-throat, and pricing for good names is below that for some similar companies in western Europe,? adds another. ?Pricing is in line with similar transactions in Spain because of the aggressiveness factor,? he says.

A third banker shares this assessment, and indeed has rarely joined syndicates in countries such as Hungary or Poland over the past two years. ?Our observation was that the margins have not always reflected the country risk, so we decided to step back a bit and do other deals,? he says. ?We are very selective, and though we would still do telecoms we do not want to finance the fifth GSM (Global System for Mobile Communication) licence in a country.?

In fact in the telecoms sector the differences in credit quality have been eroding fast between western Europe and the more developed countries of central Europe, and the similarities outweigh the differences on issues such as market penetration and the timetable for the introduction of UMTS.

Big players such as France Telecom, Deutsche Telecom and BT have all been downgraded during 2000, and are clustering around the single A level. Meanwhile Hungary and Poland are both sovereign investment grade countries, and their best corporate issuers can match this sovereign ceiling. Thus the difference in cost of funding is not that great between some central and western European borrowers, and local mobile subsidiaries are likely to borrow on their own name, or more likely do project loans, with no credit support from the parent.

That leaves institutions such as the European Investment Bank (EIB) and European Bank for Reconstruction and

Development (EBRD) to concentrate more on countries such as Romania, Bulgaria and Ukraine, leaving commercial bankers and bond underwriters to raise capital in Poland and Hungary.

Poland

For example in May of this year Polish fixed line operator Netia launched a Eu150 million offering of 10-year eurobonds, illustrating investor appetite for junk bond rated paper out of Poland. Standard & Poor's rated the bonds single B, which reflected the relatively early stage that Netia is in as a business- challenging the old fixed line monopoly Telekomunikacja Polska (TPSA) ? as well as regulatory uncertainties.

Earlier this year TPSA itself tapped the capital markets with a Eu475m bond offering.

TPSA still dominates the fixed line market, and in the summer a controlling 35% stake in the company was sold to France Telecom for $4.3 billion. TPSA has a cellular unit known as PTK Centertel, which suffered from making a late start in GSM via its Idea brand, but is certain to be involved in UMTS.

The two dominant GSM brands in Poland are Plus GSM and Era GSM, whose advertising campaigns and promotional campaigns are hard to avoid in any major polish city. Conglomerate Elektrim and Deutsche Telekom control Polska Telefonia Cyfrowa (PTC), which operates Era GSM. Its big rival Plus GSM is operated by Polkomtel.

Both Polkomtel and PTC were in the market with large syndicated loans closing in September and October, with both deals led by Deutsche Bank.

Polkomtel was largely inviting banks which had participated in a previous loan to come in on the latest syndication, which comprised a PLN800 million ($174 million) tranche and a Eu400 million tranche.

?Two years ago there was a big oversubscription on a zloty loan for Polkomtel, and their 1998 projections have been fulfilled with a large surplus both with regards to the number of subscribers and profitability,? says Krzysztof Szyszko at Kredyt Bank in Warsaw, which is part of the Belgian KBC group. ?The existing GSM operators have the best chance for UMTS since they have experience in the market and infrastructure in place,? he argues, and so have a good chance of getting financing even when UMTS comes along.

?There is a lot of interest from overseas banks in Polish debt,? adds Martin Slattery, director at Wielkopolski Bank Kredytowy (WBK) in Warsaw, a unit of Allied Irish Bank, which also controls Bank Zachodni.

?Lenders particularly like shorter term loans like Polkomtel in the telecoms sector, whereas in the power sector they are going out to 15 years, and in this territory you need specialist project finance banks or banks who know the domestic scene very well,? he explains.

?We have a funding base in zloty, and with AIB we can also fund the foreign currency element,? Slattery says, so the group often participates in both the zloty and foreign currency tranches of syndicated loans, either via AIB itself, or via one of the two banks the group controls in Poland.

Bankers say that pricing was quite tight on the two loans, at 70-90bp depending upon the particular tranche. They suggest that this may widen out for borrowers in 2001, particularly since the commercial banks are re-assessing their telecoms exposure.

In addition to doing international syndicated loans the Polish telecoms companies are also likely to be looking to the domestic equity and bond markets during the next 12 months. Sizeable offerings of commercial paper are possible in Poland, where the CP market is active out to maturities of 12 months.

This year Polkomtel launched a program with an upper limit of PLN350 million, led by Bank Handlowy, Deutsche Bank and Abn Amro. The biggest single program in the market is that of TPSA, which has a limit of PLN1.4 billion and is led by Bank Handlowy.

But the bond markets still need a lot of development. ?If you look at Polish institutional investors, banks, pension funds and insurance companies they have strict rules on what they can invest in, and they won't buy illiquid issues, they say unless there is a liquid secondary market they won't invest because they have problems pricing the securities, and they need a way out if they want to sell,? says Piotr Kowalski, vice-president of the management board at the Central European Rating Agency in Warsaw.

?The main problem is the lack of secondary market liquidity, in the energy sectors and for highways we need a lot of zloty financing, but we cannot find the necessary demand in private placements so we must look at public offerings, but the Warsaw Stock Exchange does not provide a liquid and cheap secondary market for bonds,? adds Wojciech Lipka, president of the management board at Cera in Warsaw.

However the Warsaw Stock Exchange is currently in the process of taking over the Over The Counter market, and it is hoped that by 2001 there will be a deeper and more liquid bond market.

Certainly the appetite for zloty bonds is on the increase, and share offerings in sectors such as power and telecoms will also have a deeper investor base to tap into. ?We now have new types of investors, the pension funds, they can invest up to 40% of their funds on the stock exchange, so the worry is that the supply will be too small rather than demand being too small,? says Artur Szeski, deputy director of research at CDM Pekao Securities in Warsaw. He explains that there have been some delays in transferring some premiums from the old system, but that an average of PLN600 million a month is now being transferred from old accounts.

Some of this money will end up being invested in telco shares, especially if prices fall as they have done around the world during 2000. The telecom sector in Poland is highly leveraged, and with much of its debt in foreign currency but revenues in zloty, it is running a lot of exchange rate risk.

The zloty is seen as risky because Poland has been running a big current account deficit, and economic growth has been slowing. Up to now borrowers in Euro have been helped by the fall in the value of the Euro, but borrowers in dollars have been hit, and bankers warn companies not to ignore the currency risk when borrowing in Euro. ?They don't hedge because hedging is very costly,? says a banker. ?The banks are pushing companies to hedge, but it is very expensive, and so companies are simply taking currency exposure on some projects.?

Domestic interest rates have soared during 2000 as the Polish government has tried to dampen inflation, and the benchmark rates hit a two year high of 19% on 30 August. This has driven big firms to more foreign currency financing in their funding mix, which is in turn leading to greater currency risk for mobile operators with their zloty revenues.

?Companies tended to borrow in zloty in the fall of 1999 when Wibor was at 13.5%, but then there was the reverse tendency as Wibor went up like a rocket,? says one banker. He notes that borrowers in euros have fared well because of the weakness of the euro, but that Polish corporates are still taking on too much exchange rate risk.

These risks have been reflected in some stock prices, though thus far the drop in stock prices on the Warsaw Stock Exchange has not been out of line with other stockmarkets around the world. But there are worries about cash calls. ? There is a risk that telecoms companies will come to the market looking for capital increases, since the existing mobile businesses are not generating enough cash to cover heavy UMTS investments needed, so we may be in for a long period of deteriorating fundamentals,? says Szeski at CDM Pekao.

Hungary

Hungary is the other favoured market for bank lenders, given its high mobile penetration of around 25% of its ten million population. Earlier this year PanTel, which is a KPN subsidiary, did $100 million international project finance loan for its telecoms network, and most other big players have raised finance recently.

The dominant telecoms player in Hungary is Matav, which earlier this year had a controlling stake sold to Deutsche Telekom. Matav has also made use of the domestic Hungarian bond markets, in addition to completing international syndicated loans. Earlier this year Matav established a HUF45 billion ($160 million) Medium Term Note program, the first MTN program in Hungary which was lead managed by ABN Amro, Bank Austria Creditanstalt and CIB Bank.

The appetite of the banks for Hungarian assets was illustrated in September, when a big loan for a subsidiary of Vodafone sub was syndicated, a mixture of forint and foreign currency. VRAM Tavkozlesi, which is controlled by Vodafone of the UK and whose partners include the post company Magyar Post, started GSM services late last year in Hungary.

The company raised money for the buildout and GSM licence fee via an 8.5-year project loan, with no recourse to Vodafone, which was led by ABN Amro and Citibank. Interestingly the bigger slice was denominated in forint (Eu209 million) with the remaining $120 million denominated in dollars, though bankers suggest that the local currency bank debt market can handle forint syndicated loans of up to $400 million for top class borrowers.

The margin on the VRAM Tavkozlesi loan is 85bp, though this could be reduced over the term of the loan to as little as 40bp, depending on how the financial ratios of the company evolve. One banker who did not participate says that he finds this too tight. ?Vodafone is an excellent parent, but there is no guarantee from the parent on this loan, but as usual the banks still signed,? he says, forecasting that such tight pricing will not be able to continue in 2001.

The Hungarian government intends to complete the UMTS licence process during 2001, and so most Hungarian telcos will be back in the loan markets over the next twelve months.

Other countries such as Czech Republic and Slovakia have even higher mobile phone penetration than Hungary. The forecast for the Czech Republic of 50% by the end of 2001 is a statistic that few people would have believed even a few years ago. The Czech government intends to hold its UMTS licence sale during 2001, with preliminary plans for four licences to be issued.

Slovakia also has plans to award UMTS licences in 2001. In August Deutsche Telekom acquired a controlling stake in fixed line monopoly Slovak Telecom, which gave it a stake in mobile operator EuroTel. Eurotel, together with the other existing mobile operator Globtel are both expected to get UMTS licences, which will leave room for only one additional competitor in the UMTS market.

Last year Eurotel received financing support from MIGA, in the form of insurance on commercial bank loans, and ECA or development bank support is still common in the region outside of Poland and Hungary, where commercial financing is now the norm in the telecoms sector.

Just how much these auctions or beauty contests generate in funds for the Czech and Slovak governments is highly uncertain. Observers note that some of the smaller countries in the region are not in the position of being crucial to the big west European telecoms players, and therefore an all out bidding war for licences is unlikely.

But at least the Slovak Republic and Czech Republic can rely upon commercial bank debt and foreign equity for their networks, whereas in other countries the involvement of the development banks is still a necessity.

The European Union has a target of improving the basic telecoms infrastructure across the region, and the European Investment Bank (EIB) is highly active. In January of this year the EIB lent Eu50 million to SIA Lattelekom of Latvia to help digitise its fixed line network.

In June the EIB provided insurance support on a $93.7 million eight-year loan to Bite GSM in Lithuania, which is wholly owned by TeleDanmark. In addition to the EIB involvement the balance of the loan had PRI cover provided by a private insurer.

The Baltic States are progressing well economically, but countries such as Romania and Ukraine continue to need cover on bank loans. In July the International Finance Corporation (IFC) participated in a financing package for Romanian GSM operator MobilRom, made up of a $15 million A loan held on the IFC's own books, plus a $20 million B loan provided by ING, Societe General, Dexia, BNP Paribas and Banque Worms.

The Ukraine also requires support to get deals done, and this year the EBRD made a $30 million loan to Kyivstar, the country's second largest GSM operator. This financing was accompanied by a quasi equity/sub debt facility of $4.2 million, while there was also $54 million worth of vendor financing from Ericsson.

Croatia has also benefited from EBRD involvement, though enthusiasm from commercial bankers is growing fast. In late 1999 the EBRD was involved in a financing for VIP-Net GSM, to hep it construct the country's second GSM network.

The EBRD lent Eu22.4 million, with the Nordic Investment Bank putting up another Eu20 million. There was also a Eu77.6 million syndicated loan guaranteed by export credit agencies OeKB of Austria and EKN of Sweden.

Such complex multi-sourced are becoming more common, and will continue to be a feature of the market. Since though country credits may be improving, the sheer amount of capital needed means that every possible source of financing is going to have to be tapped.

Meanwhile in the troubled countries of south-eastern Europe institutions such as the EBRD, EIB and World Bank are going to have to take a leading role in order to build up basic infrastructure, some of it devastated by war.

The EBRD is playing an important role in the South East European Stability Pact,

And in October of 1999 extended a Eu17 million loan to Makedonski Telekomunikacii (MT), the national carrier of former Yugoslav Republic of Macedonia, providing funding to help MT cope with the growing traffic of international organisations using Skopje as a gateway to the region.

And in Bosnia ands Herzegovina the EBRD has helped with the rapid progress in reconstructing the country's badly damaged telecoms infrastructure.

But in general the former communist bloc has become divided into two tiers. The more successful countries (notably those expected to be in the first wave of entrants to the EU, such as Czech Republic, Hungary, Slovenia, Estonia and Poland) moving towards west European standards in their telecom sectors. For the rest there is still a requirement to develop the telecoms network, and the goals are more those of putting in place a basic infrastructure rather than providing hi-tech services such as WAP and UMTS.