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Callahan’s £4 billion cable binge

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The wave of German telecoms financings predicted for 2000 has reached a fitting high with the massive bank and high-yield debt package arranged for Callahan North Rhine Westphalia (CNW) the cable TV acquisition.

Deutsche Telekom (DT) has been steadily divesting itself of its cable assets, and has carved its holdings into nine separate regions, in which it will continue to hold minority stakes. The proceeds will be deposited in DT's war-chest for use in big-name telecoms acquisitions, and will be added to the $14.6 billion recently raised in the largest corporate bond issue ever.

DT's new partners have been paying hefty prices to pick up the assets ? only half of the proposed funding has been set aside for network upgrade. This, in a market still split evenly between cable and satellite and characterised by a plethora of small, last-mile operators. Callahan Associates, leading the consortium that bought out the asset, plans to make the purchase the core of a competitive local exchange carrier (CLEC), offering voice data, and Internet on top of the TV services that constitute the bulk of CNW's revenues.

Callahan is an operator with substantial interests in Spain (ONO) and France (Numericable), covering six million homes. In the CNW consortium it holds a 3.5% stake, although it also manages the asset. The remainder is held by Blackstone Group and Caisse des Depots (both 25.6%), Bank of America (13.6%), Banco Santander (11.4%) and Capital Communications, amongst others. The 6.3 million homes covered by the consortium comprise the largest and most prosperous demographic of any of the nine regional cablecos.

Moreover the company does benefit from existing, and stable, revenues, although these have tended to be low, per head. The reasons for this are myriad ? chief amongst them, the proliferation of middle-men between the carrier and three-quarters of its customers, including both professional providers and individual housing associations. Callahan's main aim will be to negotiate with, or ideally buy out, as many of these bodies as possible ahead of any rollout of new services.

DT, however, makes a strange bedfellow, given that even after the disposals its own fixed-line and internet operations (including the giant T-Online provider) will be in competition with CNW. It is unlikely, given its continuing 45% interest in the venture, that it will attempt to strangle the infant at birth. Much of the mitigation of this conflict is down to interconnection agreements and DT's acceptance that it must be excluded from some strategic discussions.

The largest part of the financing comes from two bank facilities, totalling s3.2 billion. Citibank/Salomon Smith Barney, Bank of America, Chase Manhattan and Dresdner Kleinwort Benson have been mandated on the deal. The debt breaks down into a 9.5-year term loan of s2.95 billion and a s250 million revolver with the same tenor. Merrill Lynch and WestLB joined as co-arrangers before the launch of syndication, the latter as the regional Landesbank for Nordrhein Westfalen.

The debt is priced at 250bp over Euribor, but varies according to CNW's senior debt to Ebitda ratio to as low as 75bp. The opening ratio is around 8.75x. Roughly 30 banks have been invited in at co-arranger level for takes of s250 million and fees of 125bp. It is estimated that final takes could be up to half the level offered according to appetite at this tier. The bank facility has been lent to CNW subsidiary Kabel NRW and benefits from a guarantee.

The second part of the package came with around $775 million of bonds, led by Schroder Salomon Smith Barney and Merrill Lynch, with Chase, WestLB and Bank of America as co-managers. This issue broke down into $150 million of zero-coupon notes, which yield 16% and $400 million and s225 million of cash pay notes, carrying a 14% coupon. The notes carried some of the most generous spreads to appear in the market this year, and were rated B3 by Moody's Investors Service.

Market reception was broadly favourable, the more so given the yields promised, but criticism did return to CNW's difficulties in reaching customers directly. The other problem is the condition of the cable network ? sufficient for Pay TV and not much more. CNW's business plan calls for an upgrade of the single direction 450MHz broadcast technology to an 862MHz digital bi-directional network.

The eventual system should enable the operator to become a broadband provider offering an enticing menu of enhanced video and high-speed internet. It will be a mid-way point between the Digital Subscriber Line (DSL) technology currently being cautiously expanded and the full-blown fibre-optic networks whose application to the domestic end-user is still some way off. The upgrade will take several years to complete.

Even if CNW is able to take advantage of the unbundling of the local loop in Germany, threats to its position come from several quarters. In telephony, there are several CLECs aggressively rolling out their networks, especially in the highly valued urban and business sectors. Completel, in the market at the start of the year, is intending to make Germany its second greatest priority after France.

And cable TV has not yet established dominance in the German entertainment market ? a difficult task given the prevalence of free-to-air satellite content. In pay TV, DT subsidiary Kirsch is the nearest direct competitor. The value added by the range of new features will have to be established quickly to prevent CNW's potential from being squashed early on in what are still separate markets.

First mover advantage has nevertheless been gained in the deal pipeline since this is the earliest of the nine to come to the market. The next appearance will be by the E-Kabel financing, which will be more dependent high-yield debt to fund its Hesse acquisition. Merrill is again leading a $555 million issue, for a consortium led by NTL and private equity firm Klesch. Callahan, on the other hand, is now negotiating with DT to acquire a controlling stake in the adjacent Baden-Wurttemberg cable system.