

Lambdanet: First German telecoms project financing

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Germany's first non-recourse fixed-line telecoms financing closed in February. A club of banks - Dresdner Kleinwort Benson, Bayerische Hypovereinsbank and Kreditanstalt für Wiederaufbau - closed a Eu56 million facility for Lambdanet, a 'carriers' carrier' operating a pan-German network.

The financing is secured on a high-technology network consisting of a series of regional rings and uses the latest Dense Wave Division Multiplex (DWDM) and Synchronous Digital Hierarchy (SDH) technology. The network has been constructed under a turnkey contract from Nortel Networks for an undisclosed price but was finished before financing is put together.

Lambdanet is putting together a city-to-city network to be an alternative bulk capacity supplier to incumbent telco Deutsche Telekom (DT). It was formed in April 1999, as an 80% owned subsidiary of FirstMark Communications. FirstMark has been an aggressive bidder for the next generation of Wireless Local Loop (WLL) licences, the relatively inexpensive broadband technology that offers local access to Small and Medium-size Enterprises.

FirstMark intends to leverage the existence of Lambdanet's comprehensive pan-German network to bypass DT's facilities altogether. Most of the areas covered by its WLL licences are close to points of presence on Lambdanet's fibre rings. FirstMark, along with German telco o.tel.o, has provided a large part of the company's management.

Most of the fibre-optic cables run along GasLINE's pipeline network, making use of the joint venture between 15 German gas supply companies. The rights of way cover 3,500 km and have a capacity that can reach 1 Terabit. This capacity compares favourably with the larger transatlantic cables.

Germany's potential for broadband demand is enormous, a feature not lost on Lambdanet. Its director of business development, Craig Shealy, says "Germany is an extremely robust market and becoming more so by the day." FirstMark's network is approaching 45% coverage, concentrated on the country's business centres.

It is this strong business proposition that encourages German banks to take a look at a financing not familiar to the local market. Lambdanet had looked at vendor financing from Nortel, but realised that its plans were detailed enough and, crucially, the pricing good enough, to bring the banks in.

The banks came in on a club basis as underwriters for the facility, secured at the senior level. The financing has characteristics similar to the recent wave of start-up fixed-line deals, although it is far more conservatively structured.

The normal risk factors associated with analysing a telecoms start-up's business plan were mitigated to a great extent by the fact that the project itself was already being put into place, in Shealy's words that "our products were defined fairly early."

At present, Lambdanet has a number of diverse carriers lined up, including a broad mix of voice and data carriers of diverse origin. Until FirstMark's network has been more thoroughly rolled out, these flexible contracts will remain the mainstay of Lambdanet's business.

Lambdanet had been in talks with the banks since the end of the summer 1999 about possible structures, including the relationship between the Nortel contract and financing requirements. The bank facility has not been necessary until the network roll-out is complete, although some equity has been necessary.

As the first purely German deal of its type, detailed analysis of the characteristics of the German telecoms market was required. Wolfram Petzinger, vice-president in telecoms project finance at Dresdner Kleinwort Benson in Frankfurt, says that the independent consultants' study that they commissioned confirmed the Lambdanet business plan.

Dresdner have been involved with some of the larger fibre-optics deals of last year, including the Global Crossing and FLAG transactions. Compared to these deals, Petzinger says, "the structure is not over-elaborate, but addresses the risk factors adequately." The deal is tightly covenanted on variables including the size of its subscriber base. With Lambdanet coming in at a total cost of \$56 million, and financing related to a defined asset it is probable that the more unusual mechanisms would not be required.

Lambdanet believes that it has found a useful niche. Shealy is confident that its focus on the carrier business will be fruitful: "The advent of new competition would be welcome - we've got the most complete network outside of the incumbent. No-one is really positioned as we are, so we hope to make ourselves indispensable."

Nevertheless the signs of increased activity are there. DT wants to sell off its cable interests in the country, starting with a majority stake in its North Rhine and Westphalian operations. This cable, whilst dedicated to television traffic at the moment, may soon be upgraded.

The most committed investors so far have been US private equity firms, along the lines of Sandler Capital, one of FirstMark's partners. These veterans of the maturing telecoms market in the US know that broadband is going to be the buzz that brings networks the finance they need.

The Lambdanet financing is due to go into syndication to a select group of investors shortly, and the banks have been in discussions with the sponsor about the strategy to take during the pitch. Since the telecoms market is in rude health and the amount of debt to be sold down is small this should not present too many problems.

Details on the tenor and the pricing of the deal are as yet fairly hazy. However, and again with reference to the sum involved, the tenor is not thought to be beyond seven years. The pricing is within the 200-400bps range, avoiding some of the more adventurous pricing structures that have come to the market recently.

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