Shaking the equation

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The standard telecoms project finance equation is reversing. While high profile first tier market deals like Iridium and ICO suffocate under unsustainable debt burdens and outdated technology, Africa's telecoms sector has the potential for enormous growth where tried and tested technology will suffice.

Africa is a telecoms market overshadowed and undercapitalised by western deals and western investors. State telcos do not have the balance sheet to sustain much debt and foreign investors have tended to shy clear of massive cash input ? too politically risky.

But says Richard Addington, telecoms project financier at Standard Bank in London, ?the scope for technological leapfrogging and the use of pre-pay technology,? mitigate many of the normal risk associated with deals in both first and second tier markets.

Sub-Saharan Africa has a teledensity of 1.7% which is under-representative of the real potential. The international Telecommunications Union claims that teledensity in Africa in those countries where annual incomes are $350 should be 2%. Take out the richer economies of Botswana and South Africa where density is 10%, and that original 1.7% becomes minuscule.

In the past five years some $95 billion has been raised in global telecoms privatization, but only $1.7bn came from Africa and again most of that was raised in South Africa, Ghana, Guinea, Senegal and the Ivory Coast.

The geosociological map dictates that the growth markets will be in cell phones and wireless technology as technology becomes affordable to populations in remote areas.

State telecom operators in Kenya, Uganda and Tanzania, for example, are regarded as more valuable because of their licences than their existing physical assets.

Data transmission, internet and other peripheral licences (payphones, VSAT transmission, or teletrade centres) will provide another opportunity for project finance. Already 44 of the 56 countries in Africa have full Internet access.

A number of projects signed in 1998. Egypt Telecom announced a $555m upgrade and Telekom South Africa has awarded a contract worth $15 million to Gilat Satellite Networks. More projects are in the pipeline. Telkom South Africa is heading up the sponsors on the $100 million Vodacom expansion which is in financing.

The dealflow is symptomatic of a race between South Africa and Egypt for domination of the continent's markets. Within that tussle the domestic banks and a few foreign contenders ? notably Barclays and Standard Chartered Bank ? are fighting for market share.

Standard Bank completed two financings last year. The first involves a regional data network worth $8m linking Kenya, Uganda, Zambia, Zimbabwe, Malawi and Ethiopia.

The project finance uses quasi-equity raised from a consortium comprising a regional bank, an equipment supplier and an operating company. The market for this and other data networks is large. It is still difficult for banks to communicate with each other, even within a small country network, while many of them resort to telex or courier services such as DHL to pass even basic data. Most African countries have few ATM (automatic teller machine) networks, because of the inadequacy of data communications. This project will offer a relatively inexpensive and simple VSAT-based solution.

Standard Bank found a technical partner to the early stage sponsor, compiled much of the early due diligence and finally, arranged the remainder of the finance.

The next stage in the inter-regional transmission link will extend the data link to Namibia, Botswana, the Democratic Republic of Congo and Burundi. This could be worth $200 million.

Standard Bank and its local partner, the National Merchant Bank of Zimbabwe, also completed financing for the Econet cellular project led by the tenacious Strive Masiyiwa.

This project was close to completion in 1996, but development was halted by intervention from the Zimbabwean government under Emergency Powers. The project narrowly escaped abandonment, but after considerable effort, the government position was over-turned by a landmark ruling by the Supreme Court in December 1997. Masiyiwa did not want a strategic equity partner and had little previous cellular operating experience, increasing the challenge to its advisers.

Exposure to foreign exchange liabilities would have been risky for the predominantly local currency earning project, particularly given the volatility of the Zimbabwe dollar.

So it was decided to concentrate on an IPO both to international and local investors, together with an onshore debenture issue.

Despite poor news from Zimbabwe and emerging markets in general, the project closed in August 1998 and was significantly over subscribed ? over 20,000 subscribers within 4 months.

There are a number of telecoms deals in the pre-financing phase. In Botswana one of the two cellular licences has already been awarded to a consortium comprising Portugal Telephone International and TSM of Zimbabwe.

And across Africa bankers are bullish about opportunities in the pre-payment market niche.

This was particularly successful when it was introduced in South Africa.

Newer projects in Zimbabwe and Uganda this year have found it an ideal way of accessing the high density areas without bad debt. Pre-payment distribution is key in both countries where there are close tie-ups with petrol stations and retail outlets to distribute pre-payment cards.

The existing state-controlled telecom operators in Africa are unable to extend tele-density because of cost and their existing heavy indebtedness.

As a result, many local ministries, with encouragement from the multilaterals, have concluded that the answer lies in private provision, either through the issue of new licences or the privatization of incumbent operators.

Throughout Africa there have been a number of privatizations of state-owned utilities with varying degrees of success.

More are following including KPTC (Kenya), UTL (Uganda), Nitel (Nigeria) and TTCL (Tanzania).

The race is on for new telecoms licenses which typically have a duration of 15 years. But the brunt of capital expenditure is borne in the first two when the backbone of the infrastructure is built up. Bilateral and multilateral sources will provide finance for an eight year term, though 10 or 12 years is possible.

Such licences come with unexpected political risk. Nigeria is reviewing GSM licenses granted to six companies between January 1998 and May 1999. Nigeria is to halve the licenses issued and the threatened licensees are already threatening court action.

As a means of overcoming local currency and political risk, Standard Bank has used an innovative method of raising capital through the domestic stock market in Uganda. A trust has been established to offer a pool of liquidity for the market, effectively acting as an artificial market maker when local liquidity is scarce and terms short. In this way Standard Bank has succeeded in attracting long term local currency denominated non recourse finance from sources such as pension funds and insurance companies.

Such structures mean that development institutions achieve their objective of developing capital markets in under-developed areas of Africa. The issue of public debt becomes a path finder for the later issue of equity.

Standard Bank London is also acting as adviser and arranger raising $32m in debt and quasi equity for a telecoms project in Uganda. The problem of foreign currency exposure against Ugandan shilling receipts is partially alleviated by plans to raise up to $21m of the $32m locally.

In South Africa the first two licences were awarded to Vodacom and MTN (Mobile Telephone Networks) and together these two operators have introduced more than two million subscribers since 1994 and have a turnover of around R4bn ($700 million). Vodacom is 50% owned by Telkom of South Africa and Vodafone UK has 31.5% of the equity. MTN is controlled by black empowerment groups including Johnnic.

A direct 18.5% interest in MTN was acquired by Johnnic for almost R2bn financed by from Cable & Wireless (South Africa). Johnnic has recently disposed of 5% of MTN to black empowerment groups.

Though the licence issue is technologically neutral, it is likely that the winning consortium will present a dual band 900/1800Mhz solution, alleviating much of the CBD (central business district) congestion and accessing new under developed communities.

In west Africa since the partial privatization of Ghana Telecoms three years ago there has been substantial rewiring and almost all districts are now on the network. Ghana Telecoms is now operating under a Malaysian administration. Accra the capital and all the regional capitals have had their telecom infrastructure refurbished. And cellular technology is available from three private operators: Mobitel, Spacefon and Celtel.

Africa has the advantage of hindsight in the telecoms market. What can become financial tragedies in more advanced markets supply the template for further African deals.

And the chances of an African deal becoming surpassed by new technology are far more limited than in other telecoms markets.

But there are pitfalls and they can be big ones.

Many companies plan in US dollar terms and fail to allow for devaluation, a factor that cannot be passed on to the consumer in tariff increases. The project's structure must be scoped so that it can be flexible, effectively structuring each milestone of project development as a self-sustaining phase, with a call option on the next stage.

Similarly, there are limits on the amount of capital available in domestic funding markets.

Irrespective of innovation, tapping African pension and insurance funds is a limited option given the amount of investment the continentents telcos require.

And currency hedging structures aside, as Nigeria may decide to demonstrate ? one government's guarantee can amount to nothing in a political climate characterised by sweeping changes of direction.