Financing Esat Telecom Group plc

Gerald Lawlor and Neil Parkinson of Esat Telecom Group Plc give an overview of the financing of the group.

Esat Telecom Group Plc (Esat) is a facilities-based alternative provider of broad-band data, internet, video and voice services in the Republic of Ireland. It provides primarily to business and indirectly to residential and smaller business markets, over its own national fibre optic network. Esat is the group holding company that combines 100% of Esat Telecom (the fixed line operator) together with its 49.5% holding in Esat Digifone. The latter operates one of two wireless communication systems in Ireland, under a GSM or digital licence covering the Republic.

Financing requirements

Financing a telecommunications company such as Esat in an Irish context has its own particular characteristics. The investment requirement of the company has to allow for significant operating losses which will be incurred in its initial years of operation as the company builds out its networks and develops its own customer base. Esat's shareholders had initially made their investment in anticipation of returns after the liberalisation of the marketplace and the switch on of the company's local and national networks. In Esat's case, this results in a three-to-five-year funding requirement prior to the company generating its own profits and resulting cash flows.

The group's fund-raising activities have reflected the different stages of development and associated investor risk of the company history (*Figure 1*).

Both Advent's initial investment in 1994 and the equity placement in 1996 were by way of convertible loan stock, which was quasi-equity and merely gave the investors a slight preference to the other shareholders on liquidation, should that have happened. Advent's initial loan stock converted to equity prior to the 1996 funding, while the 1996 loan stock converted concurrent with the IPO.

The bedrock of effectively $50m of equity allowed the group to tap into an additional form of financing which was then not available in Europe – the US high yield or bond market. The term high yield reflects the risk profile of companies raising capital and consequently rewards the institutions that invest in such companies with higher yields than they could ordinarily expect to make, by lending funds to 'blue chip' or investment-grade companies. This has been a successful form of financing in the US and has led to some funds investing solely in high yield issues.

Although in these days of historically low interest rates this form of debt may appear relatively expensive; it should be viewed as quasi equity – and cheap equity at that. Only recently have European institutions started to become comfortable with this type of capital and in the past 18 months the number of euro-bond offerings has increased. High yield issues have traditionally been associated with both utility and technology companies, reflecting the capital-intensive nature of those industries.

High yield debt financings

Since 1996, Esat has gone to the high yield markets on three occasions to raise its debt requirements:

January 1997 – Esat raised $85m in the first of its high yield debt financings. The debt comes on a non-cash pay basis for five years during a period when the group has a net cash requirement. While there is a coupon of 12.5%, it has minimal restrictive covenants none of which impair any financings associated with the growth of the telecom's business and imposes limited representation or reporting requirements. It was sold by way of private placement known as 144A financing, but included a mechanism to exchange the initially private bonds to publicly traded bonds.

This is the preferred method of financing for many US institutions. It has the advantage of being not only a tried and tested product, but one that can be implemented relatively quickly in comparison to traditional bank financing methods. The conversion of the bonds to publicly tradable ones involved going through the registration process with the Securities and Exchange Commission (SEC) in the US. The SEC reviews a company's registration statement or prospectus for accuracy of information and for compliance with generally accepted accounting principles. This process was completed in July 1997.

August 1997 – When Esat signed a memorandum of understanding (MOU) with CIE (a state-owned national railway carrier) to install a national fibre optic network along the rail network, the group decided to prefund this project, the group had been considering an initial public offering (IPO) but determined that the equity markets were sufficiently unsettled to justify a deferral at a time when the true value of the company would not be realised. Again, the group decided to fund the project in advance of its actual requirement.

Since the previous offering the group had launched Esat Digifone, had experienced continued growth in Esat Telecom and had signed a deal with CIE which resulted in a favourable disposition towards Esat. Consequently, the group's bonds had been trading well. As the group had just gone through a registration process for the exchange of the original notes issued in 1997, the time involved in getting the registration statement approved by the SEC was minimal and the group was able to act very quickly to complete the transaction in mid-August for the additional $35m.

In the January offering the management team had a two-week roadshow throughout the US while the subsequent offering was marketed by a

FIGURE 1
Funding history

The funding of the group to date can be summarised as follows:

1991–5	Initial seed capital invested by Denis O'Brien & others.
1994	Advent International invests $10m in venture capital.
1996	Five US institutions invest IR£27m in convertible loan stock.
1997	
Jan	Company raises $85m in high yield debt in private placement in US market.
Aug	company raises $35m in high yield debt in public offering.
Nov	Company lists on Nasdaq in initial public offering raising $86m. The IR£27m convertible loan stock is then converted into equity.
1998	
June	Company issues primary stock for $40m while placing $146m for existing stockholders.
Nov	Company raises $160m in high yield debt of which about $36.1m has been escrowed for the first two years' interest payments.
1999	
June	Esat Telecom Holdings and other wholly owned related companies raise €190m in senior debt facility.

single conference call. The January offering was taken up by 42 qualified investment buyers, while the August offering was spread over just three institutions that were happy to take up significant positions in the bonds. Also, as the group had continued to perform well and meet, if not beat, expectations, the August funding was completed at an effective coupon cost of 11 7/8%.

November 1998 – The group again accessed the high yield markets in 1998 with a gross offering of $160m senior notes at 11 7/8 % due 2008. This debt was raised to part fund the continued construction of the company's, local, national and international fibre optic networks, to make scheduled capital contributions to Esat Digifone and for general corporate purposes. Some $36.1m was escrowed to pay for the first two years' interest payments.

Initial public offering

The preparation process for the IPO was similar to that of the high yield debt offerings. The same prospectus was updated for the current business and regulatory position of the company while being tailored to suit an equity rather than a debt offering. Having being through the process twice in the previous 12 months and having resolved the accounting and disclosure requirements of the SEC, we completed the bulk of the preparation in-house. The choice of underwriters for the equity offering was different, since the targeted distribution would be 50% to Europe while the high yield debt offerings were primarily US focused.

The same underwriters were chosen but in a different format that was suited to the equity nature of the transaction. This included the addition of Davy's to the international bookrunners to give support in the Irish and European tranche, while Cowen & Co were added to the US tranche to give additional distribution and research support.

The company returned to the equity markets in 1998 with a secondary public offering of $213m. Of this $40m ($37m net of expenses) was raised for company purposes with the remainder being offered on behalf of the existing shareholders of the company.

Senior debt financing

In June 1999, Esat Telecom Holdings Limited (a direct wholly owned subsidiary of Esat Telecom Group Plc), and several other related wholly owned subsidiaries, as borrowers entered into a secured revolving credit agreement with a consortium of senior bankers. This facility is available through revolving loans and makes available to borrowers an aggregate amount of €190m. The facility is cross-guaranteed by each borrower and by each material subsidiary of such borrower. The facility also included some unusual features such as deferring capital payments until the end of the facility in 2004.

The raising of this senior debt facility signified that senior borrowers were now prepared to look favourably on the company. It also signified an improved view on the company's risk profile as evidenced by the upgrading of its rating with Moody's from a triple C to a B3.

Keys to successful fund-raisings

There are several key criteria to ensure the successful placement of either a high yield debt offering or an IPO. Other than the obvious requirement to have a sound commercial basis for raising the finance it is key to appoint the correct underwriters, who have specific strengths that address the targeted markets. We appointed Donaldson, Lufkin & Jenrette together with Credit Suisse First Boston, which had assisted the company in raising IR£27m in convertible loan stock and would split the responsibility for marketing the company in the subsequent IPO. Within each appointed organisation it is equally important to identify the executives who understand the company's position and requirements and will work with the company and its client to achieve best solutions.

Good support in the transaction is essential to an easier and successful transaction. The company received support from its lawyers, auditors and Connolly Corporate Finance, which helped the company chart its way through the financings. It is vital to ensure that the company receives independent experienced advice which it can rely on as being in the company's own interest. The last piece of the jigsaw was completed by the addition of US lawyers, Davis Polk and Wardwell, which provided not only the legal technical expertise but also the invaluable commercial advice on the practicability of the legal and regulatory advice.

A long-term view

Financing in a telecommunications company involves taking a long-term view supported by a sustainable and achievable business plan. This is the base for enabling the company to raise finance by a variety of available instruments, which are tailored to the company's needs. This has resulted in investment by individuals and financial institutions, which take a growth return in the short- to medium- term in the knowledge that profitability will follow the implementation of the business plan. ■

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