Cablecom refinancing points to debt market convergence

Swiss cable TV operator Cablecom has broken new ground with its innovative refinancing that combines senior secured notes and a revolving credit facility. Will other corporates replicate the structure or is it just a flash in the pan? Bryant Edwards and Christopher Hall assess the likelihood

The recent landmark Cablecom Luxembourg SCA refinancing garnered much attention throughout the negotiation process and, now complete, raises questions for the industry.

Was the transaction just a flash in the pan or a possible model for the future of European financing?

The SwFr390m (£172m)/€575m (£387m) senior secured notes and SwFr150m (£67m) revolving credit facility issuance for Cablecom highlights the continuing convergence of the bank and debt capital markets.

The transaction fully refinanced underperforming investment grade debt with three issuances of five or seven-year notes and a revolving credit facility, all of which rely on financial and other undertakings that have their origins in the high-yield market rather than bank debt.

Most unusual in the covenant package of a combined term and revolving facility are:

- The replacement of maintenance financial undertakings, such as leverage, fixed charge cover or interest cover thresholds required to be maintained over time and tested periodically, with a debt incurrence limit – capping senior and subordinated debt incurrence at different multiples of trailing Ebitda – tested only upon incurrence of the relevant debt.
- The absence of any undertaking limiting capital expenditure.
- The absence of non-financial undertakings relating to acquisitions, investments, disposals and the like.

The issuing group is therefore free to operate and grow without the burden of a wide variety of constraints that would typically be found in debt instruments issued by companies with similar credit profiles.

The marketability of the revolving credit facility is enhanced by the granting of security over a limited category of assets of Cablecom GmbH, the group's principal operating company, that is available to the revolving creditors but not to the holders of the notes. However, it does not benefit from a guarantee of super-priority of recovery and is otherwise on terms substantially identical to those governing the notes.

The differences between this transaction and what has gone before have inevitably led to a debate over whether it is a one-off event or evidence of a shift away from bank debt to debt with capital market undertakings and other characteristics that put fewer constraints on the issuer.

Growing acceptability

As other evidence of the trend towards the general acceptability of capital markets debt, high-yield issuances by European issuers, or involving issuance in European currencies, exceeded €20bn (£13bn) in 2004, by far the highest amount for a single year so far.

Until the Cablecom transaction, the high-yield covenant model had not penetrated so far as to encompass revolving credit arrangements – and thereby eliminate bank debt financing from the balance sheet of a below investment grade company that had demonstrated continued ability to comply with its covenants but had voluntarily determined that it would seek a less constraining covenant model to enable it to achieve its growth potential.

Some factors suggest that if this issuer could achieve access to this relief from the constraints of maintenance-based financial undertakings and extensive non-financial undertakings, many other potential issuers could do the same.

Not all factors indicated that this particular issuer would benefit from flexible treatment in such a ground-breaking way. For example, the Swiss tax laws governing

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Cablecom GmbH do not permit the operating company to grant security over its assets in favour of the holders of the notes – unlike the holders of the revolving credit. This leaves the vast majority of the debt in the transaction to act as an instrument that derives its structural and ranking integrity from the second-choice method of limiting access by other creditors to asset security, rather than by benefiting from such security itself.

If asset security were available to the notes as well as the revolving facility, the transaction may have been far simpler in its execution and distribution.

The transaction was structured to accommodate a pre-existing high-yield note issuance that diminished full freedom of negotiation.

In addition, the transaction was completed less than 18 months after a significant debt restructuring had wiped more than SwFr2.5bn (£1.1bn) off the balance sheet.

On the other hand, some factors in the transaction were more favourable and therefore suggest that this development has relatively limited application to the debt markets in general and is not an opportunity available to a large number of interested potential issuers.

Hitting the high point

First, and most obviously, the European debt markets enjoyed a unique vitality during the first few months of 2005. While this vitality was showing signs of waning by the time of pricing this transaction, the markets were still near a historical high point, from where they have significantly receded since then.

Second, the company benefits from strong financial sponsorship that is deeply experienced in the European cable markets.

Third, it had enjoyed significant operational and strategic success – particularly in the area of new product implementation and distribution – since its debt restructuring and was able to demonstrate that capital expenditure for maintenance was highly controllable, the only need for growth in capital expenditure being for implementing new products for new customers.

Fourth, the company enjoys an unusually predictable cash flow from its operations and working capital cycle.

No doubt the answer to whether the transaction was a one off or whether it signals the future for European financing lies somewhere in the middle and it will require a resurgence of market conditions before the importance of this development can be accurately gauged.

At the very least, the Cablecom transaction shows that the debt markets continue to converge and that credit risk can be evaluated and priced in an ever-increasing number of ways, giving rise to a nearly infinite number of potential new structures.

The Cablecom notes have performed favourably since issuance, when compared with other issuances in the telecommunications sector, suggesting that the recent downturn in the market has not called into question the acceptability of the structure of the transaction.

In addition, news is beginning to circulate of similar transactions coming through, though perhaps these will add some incentives to the revolving debt portion, such as the granting of a super-priority position on proceeds of enforcement or the inclusion of one 'debtor friendly' maintenance covenant.

Potential issuers of debt wishing to carry out a similar issuance should watch for developments in this area.

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