FTTH SECTOR PROVIDES INFRA BOOST

THERE HAVE BEEN A WHOLE RANGE OF FIBRE TO THE HOME (FTTH) DEALS IN THE MONTHS LEADING UP TO LOCKDOWN AND IT IS NOT GOING TO STOP ANY TIME SOON. BY LAURENT CHABOT, CO-HEAD OF INFRASTRUCTURE FINANCE, PARIS, AND JONATHAN TWEED, HEAD OF TMT FINANCE, LONDON, SOCIETE GENERALE.

The lockdown has highlighted that fibre is an essential public service. The business case for digital infrastructure assets is strong and we continue to see a resilience in the appetite from both banks and institutional investors, with significant financial closes in the past three months, ongoing processes and new opportunities.

The amount of the FTTH financings in Europe in the past 18 months is unprecedented, with jumbo deals such as the so-called Piano and Violin transactions in France; Inexio and Deutsche Glasfaser in Germany; Cityfibre and Hyperoptic in the UK.

There had been previously visible transactions, such as the landmark €3.4bn financing of Open Fibre in Italy in August 2018, Ufinet in Spain and a string of concession projects in France since 2016, but the size, the number and the variety of FTTH deals – in terms of jurisdictions, financial structures and revenue profiles – in 2019 and Q1 2020 is striking.

Societe Generale had a major role in most of these transactions, with 20 deals and over €15bn in financings either as financial adviser and/or lead bank in a half dozen countries.

Macro overview and benefits of fibre

The backdrop to increased demand for FTTH is the exponential growth in global internet traffic that is expected to continue for many years. At present, traffic is dominated by video applications, streaming and an increasing share of video gaming. Outside of consumer demand, automation across many industries is accelerating the growth in the Internet of Things.

Given the explosion in data consumption that we see now and, in the future, fibre is the only solution. It offers a fit-for-purpose product to address the increasing needs of customers and is future-proofed to enable evolving technologies, such as 5G and connected cities.

The key characteristic has been the strong resilience of the sector through the Covid-19 crisis. The crisis has demonstrated that broadband connectivity is an essential service and has increased the appetite from investors in both the credit and equity markets.

Although legacy telecom networks have held up with increased usage, investment in FTTH produces networks that have a higher level of autonomy and redundancy, which is needed for such an essential service.

Key investment highlights

The fibre financings have different features but usually involve a construction and a commercial/market risk. The construction risk is generally considered as low, as it is usually mitigated by high visibility on capex, EPC contract and monitoring of the roll out by lenders' technical adviser. Transactions often include during the rollout a maximum ratio of debt to households passed to monitor the drawdowns on the debt.

Though there is no legal monopoly, targeted areas are generally viable only for one neutral operator, which has the first-mover advantage and provides open access services available to all retail operators. The risk of potential competition is obviously weaker in medium or low density areas, where the lenders take comfort from de facto monopolies/strong barriers to entry – concessions, subsidies….

The volume risk on future FTTH penetration, and potential competition in dense areas, raises the question of take-up in the respective regions. Lenders rely on independent traffic due diligence to assess the risk and determine adverse scenarios.

Some transactions also have existing cashflows from legacy activities – Ufinet, Deutsche Glasfaser, Eurofibre, Open Fibre, SFR FTTH. There can also be, though it is not the most frequent, offtake contracts with commitments of an anchor operator locked for a long-term period at financial close.

Three most active markets

- *Germany* – Germany has the second-lowest FTTH penetration level in Europe. This has been driven by a regulator and Deutsche Telecom focusing on fibre to the cabinet (FTTC) and enhancing the speed of the copper network through vectoring.

The existing networks have become congested and there has been a focus on alternative networks to supply the growing need for FTTH. Approximately one-third of households only receive copper based internet with speeds below 10 mbs/second. This has led to a large addressable market for two newer entrants, Deutsche Glasfaser and Inexio.

KKR acquired Deutsche Glasfaser in 2015 with a plan to roll out FTTH to rural and suburban areas without the need for subsidies. Since then, the company has outperformed against its business plan and has been refinanced twice. The latest transaction in January 2020 raised €1.8bn including a €400m accordion facility shortly before Deutsche Glasfaser was acquired by EQT.

Under the ownership of Warburg Pincus, Inexio rolled out a FTTC network in semi-rural Germany in areas that were not in competition with Deutsche Glasfaser. In 2019, the company changed its business plan to roll out FTTH in its footprint and Inexio was sold to EQT in 2019.

In connection with the acquisition, the company raised a debt facility of €1bn that was successfully syndicated in 2020. Although run separately, the acquisition of both networks by EQT provides a key strategic player in the German fibre market.

● *UK* – The UK has one of the lowest FTTH penetration rates in Europe but the highest level of internet usage. The lack of FTTH has been driven by BT Openreach being incentivised to upgrade its legacy copper network rather than replace it with FTTH. This has been coupled with a demand-led approach to fibre, lacking coordination and numerous barriers, which have delayed investment.

Providing FTTH to the whole nation by 2025 was one of the key promises made by the current government in 2019 and this has led to a large number of recent transactions and a healthy pipeline of rollouts by financial sponsors and strategic players.

In 2018, Cityfibre put in place a debt package of £1.12bn to fund the first stage of an ambitious rollout plan to connect five million households to an open access network in partnership with Vodafone. This is the largest fibre financing to-date in the UK and Cityfibre upscaled its business plan with the acquisition of FibreNation in 2020 to bring TalkTalk on to the network.

Hyperoptic, the UK's largest residential gigabit broadband service provider, was successfully acquired by KKR in 2019 and refinanced with a £500m debt facility to support the company in its targeted rollout to five million households by 2024. The refinancing doubled the facility from £250m which was placed in 2018.

● *France* – The French government set the scene in 2013 with the national ultra-fast broadband plan (Plan France Trés Haut Débit), which initially targeted coverage of 100% of the population by 2022 – 80% through FTTH and 20% through alternative networks: cable, satellite.

It has clearly separated private and public initiatives, according to the density of the areas: in very dense areas, there is full competition on infrastructure; in medium dense areas (AMII zone), an exclusive sharing agreement between Altice and Orange; in low-density areas, public initiative networks mostly rely on concessions launched by local governments.

This set-up has been quite successful and the transition from broadband to superfast broadband access continues at a steady pace. According to the French regulator ARCEP, the number of superfast broadband subscriptions increased by 725,000 over the course of Q4 2019 to reach 11.4m. This means an additional 2.4m subscriptions over the course of 2019, versus an increase of 2m in 2018. Thirty-eight percent of all subscribers in France now have a superfast access line, which is up seven points year-on-year.

French fibre financing really took off in 2016 and developed steadily in the next three years. While the integrated operators Orange and Altice initially financed their operations on their balance sheet, the independent wholesale operators – Axione, Altitude Infrastructure and Covage – largely used project finance in 2016–2018 with a total financing amount of around €2.5bn.

The financing structure of these deals was inspired by the soft mini-perm structures often used for motorway concessions, which also have volume risk and a ramp-up period. Soft mini-perms typically have contractual tenors of 20–25 years and strong incentives to refinance after completion and ramp-up, ie step-up margins and increasing cash sweeps post-completion.

Two jumbo deals have changed the French fibre landscape since 2019: SFR FTTH and Iliad's IFT (Investissement dans la Fibre des Territoires). The deals initially had a musical flavour as they were respectively named Piano and Violin.

While the average concession financings were relatively small, below €200m with a few exceptions such as Grand Est or Nord Pas de Calais, Piano and Violin are a dramatic change from chamber music to symphonic works, with financing amounts circa €2bn each. Both also have a seven-year tenor, a sweet spot to maximise the liquidity of banks and institutional investors.

The SFR FTTH transaction, signed in March 2019, created a leading FTTH infrastructure wholesaler in France - 5m homes to be passed in the next few years and more to be franchised or acquired – with Omers Infrastructure, Axa IM Real Assets and Allianz Capital Partners taking at 49.9% equity stake in the company.

Altice France holds the rest. SFR FTTH sells wholesale services to all operators at the same terms and conditions, including SFR, with no minimum volume commitment. Altice France sells technical services to SFR FTTH for the construction and maintenance of the FTTH network.

The €1.9bn non-recourse financing package signed by five mandated lead arrangers and underwriters – BNP Paribas, CACIB, Natixis, RBC and Societe Generale – will finance the fibre rollout over a five-year construction period. The seven-year bullet term loan benefits from project finance type of protections, including ongoing project monitoring and a relevant set of covenants and security package.

Compared with previous French fibre financings, it is a move from single asset financing to a portfolio approach, with underlying assets that are a mix of brownfield and greenfield projects, for either concessions or private investment in medium-dense areas.

Other fibre deals that closed in 2019 in France had innovative structures, such as Savoie Connectée owned by Covage and Orange, the first fibre project in a low density area to be funded through project financing without a concession framework.

The non-recourse debt is structured in the form of a variable-rate tranche of €122m with a maturity of 22 years and a fixed-rate tranche of €130m with a maturity of 25 years. The entire debt was subscribed and arranged by Societe Generale.

Last but not least, Investissement dans la Fibre des Territoires (IFT aka Violin) is a FTTH one-stop-shop for broadband operators, providing FTTH coverage in medium and low density areas through acquiring right of use on FTTH links – ie co-investing with infrastructure operators through Irrevocable Right of Use or IRU – and renting these links to retail operators, of which Free is the main offtaker. Iliad Group sold a 51% stake to InfraVia, keeping 49% of the structure.

The IFT business model is not to construct and operate physical infrastructure, but to offer attractive rental pricing to their clients as well as access to a nationwide network. The relationship between IFT and Iliad is governed by a long-term commercial agreement (Master Service Agreement), which provides adequate mitigants to ensure debt repayment in downside scenarios.

The IRU acquisition is backed by a €2,150m non-recourse financing, with four banks acting as MLAs, structuring banks and underwriters – BNP Paribas, CACIB, Natixis and Societe Generale. This seven-year term loan includes floating and fixed-rate tranches.

The syndication was successful among a diversified and international pool of banks and institutional investors. In spite of the Covid crisis, it closed by the end of March 2020. As for Piano, in addition to the structuring of the deal and the corporate relationship, it was key to have dedicated institutional tranches in order to benefit from the appetite of institutional investors for the fibre asset class.

The financing of IRUs was unprecedented and it paved the way for similar transactions.

The pipeline of fibre deals in France and other European countries, notably Germany, remains quite strong and the past few months have shown that this asset class has a defensive profile that is quite attractive for investors.

This will be key for the large deals due to be closed in the coming weeks and months to finance the rollout. In the short to medium term, there will also probably be refinancings of the 2016–2018 deals once construction is well advanced with good visibility on the ramp-up. And after Europe, non-recourse fibre debt may also develop worldwide, notably in the US. The deals and the jurisdictions will continue to change but fibre financing will remain high on the agenda. ■

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