

Ziggo: Covenant and Credit Analysis of a Potential Sponsor Buy-Out

Recently there has been talk in the market about Liberty Global's (LGI) interest in acquiring Dutch cable operator Ziggo, a company currently pursuing an IPO that could value it at around €7 billion. DXP analyzed the possibility of a sponsor-driven acquisition scenario involving Ziggo, using LGI as the example of a potential bidder, in conjunction with a credit analysis done by our friends at SpreadResearch, in order to give subscribers a comprehensive analysis of the potential next steps for Ziggo in a theoretical scenario...

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Credit Fundamentals and Recent Performance

In the first-quarter of 2011, Ziggo Bond Company reported a revenue growth of 6.5% YoY to €361 million. The revenue growth in 1Q11 was fuelled by an 8.1% YoY increase in the blended ARPU to €35.20/month, primarily driven by robust sales of All-in-1 bundles (i.e. triple-play products). 1Q11 adj. EBITDA was €205 million, up +5% YoY from €195 million in 1Q10. The EBITDA margin declined to 56.9% from 57.7% in 1Q10, as a result of higher TV content costs, a large volume of set top boxes and CI+ modules shipped in the quarter, and increased marketing and sales expenses. This is consistent with the group's strategy to focus on sustainable growth (rather than margins) in 2011. Ziggo's results for the first quarter of 2011 compares favorably with HY cable peers: organic revenue growth was lower than its German peers, roughly in line with UK cable operator Virgin Media and better than UPC Holding (active in several European countries including the Netherlands) and ONO in Spain.

Ziggo Cleans House

Ziggo has been taking steps to clean up its financing structure and extend maturities. Just days ago, lenders to Ziggo approved a request to refinance existing debt and to extend its maturity by 2-1/2 years. More than two-thirds of lenders agreed to the proposed changes, which include a new €460 million Term Loan F that fully refinances both Ziggo's Term Loan C and second lien Term Loan D tranche. In May of last year, Ziggo issued €1.2 billion 8-year senior unsecured notes to refinance its mezzanine debt. In October, Ziggo issued €500 million 7-year senior secured notes that were used to repay senior bank loans.

An IPO of Ziggo would be an interesting exit option for the current owners (funds managed by private equity firms Warburg Pincus and Cinven), given the current high valuation of listed peers (Telenet, Kabel Deutschland, Virgin Media) and Ziggo's positive operating trend. It seems likely that the IPO option would lead to continued deleveraging of the capital structure.

Similarly to Kabel BW, an auction involving private-equity firms and other cable operators could be conducted in parallel, helping Warburg Pincus and Cinven to get the best price for Ziggo. LGI repeatedly mentioned in the past that an acquisition of Ziggo could make a lot of sense, generating synergies with UPC Netherlands, its existing Dutch business (which is part of the UPC Holding credit group).

Implications under Ziggo's Outstanding High Yield Bonds of an Acquisition

Any potential bid by LGI would follow diligence of Ziggo's current debt instruments. This note assumes that the acquisition would be structured to keep the current debt instruments in place, which would require an analysis of debt and liens capacity. Ordinarily a sponsor buy-out would trigger a traditional high yield change of control covenant, but Ziggo has a famously unique version of the covenant that would result in any potential sponsor buy-out avoiding the 101% put requirement.

Given the high valuation of Ziggo (an enterprise value of c. €7 billion was mentioned in recent press articles), we suspect that an acquisition by LGI or private-equity sponsors would be mostly financed by debt, resulting in:

- A re-leveraging of the capital structure within permitted covenants, i.e. a max leverage of 5.0x (vs. 4.2x in March 2011) and the issue of subordinated debt by an acquisition vehicle.
- The amendment or the tender of existing bonds to permit a higher re-leveraging of the capital structure

The Change of Control definition in Ziggo's indentures includes traditional triggers of the 101% put requirement, subject to the company's ability to avoid making a change of control offer if it can declare it a Specified Change of Control Event. A Specified Change of Control is defined as the occurrence of any event that would otherwise constitute a Change of Control (except for the insolvency trigger), provided that immediately before and after the event (on a pro forma basis), Ziggo's Consolidated Leverage Ratio would have been less than 5x (if the event occurs within a year of the Issue Date) or 4.5x (for events occurring thereafter). Ziggo can only make this election once in the life of the bonds, and as it has not yet elected to exercise a Specified Change of Control, should LGI make a bid for Ziggo, and Ziggo is able to meet the relevant ratio, the launch of a change of control offer would not be required.

The lenders or noteholders under any additional debt issued for the purpose of the acquisition would be required to accede to the intercreditor agreement. Currently, noteholders are not party to the intercreditor arrangements, only Ziggo Finance BV (the Issuer) as Facility E1 Lender. Debt raised through the high yield markets would be likely to mirror the same hybrid structure so that the proceeds are on-lent to the Group through a new tranche of Facility E. This is expressly permitted under the terms of the October 2010 Indenture. Should Ziggo Finance increase its commitments as a Facility E Lender, its voting participation as to instructing the Security Agent or in an enforcement decision would still remain capped at 25% unless Facility E debt increases to an amount in excess of two thirds of total debt outstanding under the SFA. Unlike bank lenders of the other Facilities under the Senior Facilities Agreement, the underlying creditors of the hybrid high yield structure have no direct control over their (indirect) security. Debt raised through the banks would be likely to be included as a new term loan under Facilities B or C and would, of course, further dilute Noteholders' (indirect) voting participation. In each case the additional debt (unless expressly subordinated) would rank *pari passu* with the outstanding debt in right of payment and in the sharing of the security.

Compatibility with LGI's Existing Asset with Dutch Operations, UPC

As it is likely that Ziggo would be merged into the Dutch cable operations currently owned by LGI, operated out of the wider UPC group (which operates in nine European countries, including the Netherlands, where it has the second largest cable network), a comparison of the covenants in the two companies' debt documents would be essential to determine their compatibility. In addition, should any potential sponsor buyer be unhappy with the covenants in Ziggo their

options would be either to refinance the bonds as a part of the overall acquisition, or to launch a consent solicitation to amend specific provisions.

We used DebtCompared to analyze the compatibility of the covenants in the high yield documents for the respective companies, and unsurprisingly, as the companies operate in the same sector, their debt covenants are quite similar, while UPC appears to have significantly greater restricted payments capacity than Ziggo.

The leverage ratio for the most recent Ziggo deal is set at 4.25x. The tightest leverage ratio in the UPC deals is set at 4x, so the debt covenant in Ziggo should be broadly in line with the UPC group.

However, restricted payments capacity in the two deals differs significantly. Ziggo's restricted payments general basket is restricted to €50 million since the Issue Date, and its basket for redemptions of employee equity is €10 million per year (with no ability to carry over unused amounts). While the redemption of employee equity basket is just €3 million a year (with unused amounts carried over), UPC's restricted payments covenant (in the indenture governing its 8 3/8% senior notes due 2020) permits €50 million in restricted payments *per year* (with unused amounts carried over to succeeding years), and includes a basket for redemptions of capital stock or shareholder loans and dividends and other distributions and loans to Parents so long as the leverage ratio, pro forma, would not exceed 5x.

Both issuers incorporated an excluded contributions concept in their restricted payments covenant, which will permit shareholders to inject cash into the group for use in making restricted payments without these amounts being eroded by losses in the build-up basket.

As it would be far more difficult for a sponsor to extract cash from Ziggo than UPC, LGI may find it difficult to live with these restrictions and might seek consent from bondholders to amend them, or take out the bond altogether.

Feasibility of a Consolidation Transaction

Ziggo's covenants would also be analyzed to determine the feasibility of a consolidation into the UPC group. Our review of the merger covenant in Ziggo's bonds didn't pick up any obvious hurdles to such a transaction – as is market currently, the Issuer would be required to meet the ratio test, or ensure that the ratio would not be greater after the transaction than before, among other standard requirements. In addition, if Ziggo is re-levered to a level that is not compatible with the indenture of UPC bonds, LGI could leave Ziggo and UPC in separate credit groups, and consolidate them after Ziggo's leverage meets the ratio requirements of the UPC debt.

Potential Deal Structure

In terms of deal structure, LGI's recent acquisition of German cable operator Kabel BW provides some indication of potential structure for funding the deal. In Kabel BW, the company issued the bond that financed the acquisition – and this was done prior to completion of the acquisition, which remains subject to regulatory approvals.

Traditionally, such an acquisition likely would have been financed by a bridge-to-bond structure, whereby funds are lent by banks that ultimately intend to take the company to market to issue a bond once the acquisition closes. The downside to this structure is the carry cost of the bridge loan, which is an expensive financing instrument in terms of both interest and fees. There is also uncertainty given that macro market conditions could shift in the intervening period, resulting in the possibility of even more expensive financing costs and additional fees once the initial funding period of the bridge loan expires.

It would be essential for LGI to get management comfortable with the risk of issuing the notes prior to regulatory approvals, and advice from competition counsel on the likely outcome would be sought. LGI's chief strategy officer has been cited as being confident that Dutch regulators would not block any potential acquisition.

Another element of the Kabel BW structure involved the creation of a backstop arrangement whereby JP Morgan agreed to backstop LGI's acquisition of Kabel BW and effect a transfer to another buyer should the regulatory approvals fail to be obtained by December 31, 2011. It is likely that a similar arrangement would be established to give Ziggo management sufficient comfort to issue the bond out of the group prior to completion of the acquisition.

Conclusion

Though LGI successfully managed to prevent the IPO of German cable operators Unitymedia and Kabel BW by making attractive bids, there would seem to be certain current hurdles for an immediate bid by LGI for Ziggo:

- LGI's current cash balance at holding level is c. \$1.2 billion (excluding \$1.6 billion of restricted cash in relation to the acquisition of Kabel BW), which means that the company would need to raise funds, upstream cash from its subsidiaries and/or sell assets to bid for Ziggo (e.g. Foxtel is interested to acquire Australian DTH provider Austar, which is 54.2% owned by LGI). In relation to the acquisition of Unitymedia, note that LGI was able to quickly raise cash through the issuance of convertible notes.
- LGI seeks to complete the acquisition of Kabel BW, which still requires regulatory approvals. A bid on Ziggo would also be subject to regulatory approvals and involve substantial sums being at risk at the same time.

No information was given about a potential interest on Ziggo during LGI's 1Q11 conference call on May 5, 2011. Speculation has been omnipresent: for instance, at the beginning of April, the Financial Times published an article regarding the LGI bid to pre-empt Ziggo's IPO. The article stated LGI's position and its potential bid, as well as Ziggo's preparations regarding a flotation aimed at raising roughly €7 billion (\$10 billion). The article cited LGI chief strategy officer Shane O'Neill as saying that the prospect of an IPO was not a hindrance. The information remained uncertain, due to opposing and contradictory statements in the press, stating that LGI was in fact not poised to make a bid for Ziggo. This was stated on the company's website early April (08/04/11) and LGI CEO Mike Fries clearly said that "Liberty Global isn't currently working on a deal" and he believed that there wasn't a "transaction there for us or anybody else at this point."

It is unclear what LGI's intentions are in respect of any potential acquisition of Ziggo. The asset would appear to make sense in the context of their wider cable group, and Ziggo's bond doesn't contain many incompatible provisions that might make such a marriage difficult to sustain. One exception from a covenant perspective could be the tight restricted payments limitations – Ziggo's restrictions might be difficult for the sponsor to live with long term, so noteholders might hear from the company in the context of a consent solicitation in connection with the acquisition to widen the limitations – but noteholders almost certainly won't receive a change of control offer due to the creative drafting of issuer's counsel in Ziggo's change of control covenant.

For more questions:

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Question	UPC € Senior “Secured” 2016 13-Aug-2010	Ziggo Senior Secured 2017 21-Oct-2010
Traffic Light:	Red	Red
Name of Issuer:	UPC Holdings BV	Ziggo Finance B.V.
Listing Jurisdiction:	Ireland	Luxembourg
Amount: Coupon: Maturity	€640m: 8.375%: 15/08/2016	€750m: 6.125%: 15/11/2017
Notes Rated?	B-/B2	BB/ Ba2
Ratio Debt Test / Permitted Debt Baskets:	<p>Consolidated Leverage Ratio of Issuer and Restricted Subsidiaries (most recent 2 fiscal quarters multiplied by 2; 4.0:1.0) for Indebtedness (includes Acquired Indebtedness)</p> <p>Consolidated Leverage Ratio of Issuer and Restricted Subsidiaries (most recent 2 fiscal quarters multiplied by 2; 5.0:1.0) for Pari Passu Indebtedness (includes Acquired Indebtedness)</p> <p>Additional obligations may be secured on a pari passu basis with the Share Pledge without the consent of the holders of the Notes or the trustee.</p>	Company’s Consolidated Leverage Ratio is at least 4.25 to 1.00
Credit Facility Basket:	Pari Passu Indebtedness of Issuer and Indebtedness under Credit Facilities not to exceed the sum of €1,150 million plus the aggregate principal amount of term loan borrowings outstanding under the Senior Credit Facilities on the Issue Date	€3,500 million
Purchase Money / CLO Basket:	€100 million	€100 million
JV Basket	None	None specific
General basket:	General basket for Pari Passu Indebtedness of the Issuer and other Indebtedness of the Restricted Subsidiaries not exceed €100 million	€150 million

Qualified Receivables Transaction / Securitisation Facilities:	Yes	Yes
Other Material Carve-outs:	Debt existing at the Issue Date	Please refer to the Gold Report
Triggers for RPs/ RP Carve-outs/ Permitted Investments:	No default/EoD; Ability to incur €1 under Consolidated Leverage Coverage Ratio; Build-up under Restricted Payments basket	No Default/EoD; Ability to incur €1 under Consolidated Leverage Ratio; Build-up under Restricted Payments basket
Retirement/ Repurchase of Capital Stock:	Repurchase or retirement for value of Capital Stock of management employees or former management employees under stock option and similar plans up to €3 million a calendar year (with any unused amounts in any preceding calendar year being carried over to the succeeding calendar year)	Retirement of Capital Stock of management/employees up to €10 million each year
Excluded Contributions?	Yes	Yes
General RP Basket:	Not to exceed €50 million in any calendar year (with any unused amounts in any preceding calendar year being carried over to the succeeding calendar year)	€50 million
Ability to Retire Subordinated Obligations in Event of CoC/ Asset Sale?	No	Yes – Change of Control only
Dividends in the Event of an Equity Offering?	No	In an amount not to exceed 7% of Market Capitalisation and provided that the Consolidated Leverage Ratio (on pro forma basis) is less than 4.5 to 1.0
General Permitted Investment Basket:	Not to exceed 2% of Total Assets	€75 million

JV RP/ Permitted Investment Basket:

So long as no Default or Event of Default of the type specified in clause (1) or (2) under “—Events of Default” has occurred and is continuing,

(a) minority Investments in any Person engaged in a Permitted Business and

(b) Investments in joint ventures that conduct a Permitted Business to the extent that, after giving pro forma effect to any such Investment, the Consolidated Leverage Ratio for the Issuer and its Restricted Subsidiaries would not exceed 5.00 to 1.00

None specific

Other Material Carve-outs:

Any Investment to the extent made using as consideration Capital Stock of the Issuer (other than Disqualified Stock), Subordinated Shareholder Loans or Capital Stock of any Parent

[Please refer to the Gold Report](#)