

# Reducing Uncertainty in Converging Markets: Media and Communications

By Robert Raciti

Making financing decisions in a complicated, fast-changing industry.

For the last couple of years, the media and communications market has been vibrant. In 2005, GE Commercial Finance's global media and communications group booked more than \$5 billion of new loans and assets. In 2006, we expect to see a similar high level of activity and, already, we have plenty of deals to consider. We sense strong demand for funding across the media/communications spectrum, and it is coming from companies at different stages of growth and maturity.

GE's global media and communications group has a diverse portfolio of loans and other structured financial products. The bulk of the portfolio is composed of transactions with telecommunications, media, technology and entertainment companies. Currently, the two most significant concentrations of transactions are in cable and wireless telecom, which includes towers. Our portfolio is global; while it is U.S. dominated, about \$1 billion, or 20 percent, of our assets are in the European and Asian markets.

At GE, we try very hard to assess the benefits and risks of transactions because we believe that underwriting transactions in media and communications is more challenging than ever. One reason is that the key players are right in the middle of a convergence crunch. Cable companies are nibbling into telephony; phone service providers are pushing into video; and voice, video and data is being delivered to handsets through the air and

over the Internet. More important, the science and technology fueling convergence—that is, the chips, circuit boards, switches, towers and fiber networks, among other components—seems to change constantly. Advances in these elements of the digital revolution are opening new frontiers and opportunities every day.

Keeping abreast of all the goings-on in media and communications is the fundamental challenge to debt and equity capital providers right now. GE's in-house team of technical experts is a

valued resource for market intelligence and focuses on understanding the technical and business aspects of risk, which are often significant in the media, communications and technology fields.

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## Evaluating Industry Sectors

How does GE's global media and communications unit get comfortable with companies and make financing decisions in the context of a complicated industry? It is safe to say that we underwrite carefully and do thorough due diligence, but our approach goes beyond a standard checklist. We look at the media and communications industry, industry sectors, individual companies and transactions in as many ways as possible to understand risk. Our approach is top-

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down and bottom-up. We spend considerable time stepping back to get a view of what is happening in the media and communications industry overall. It is the proverbial big picture, and it defines top-down.

As for bottom-up, we find it useful to view the industry in terms of a value chain. Put simply, the media/communications value chain extends from core technology inputs (semiconductors, flash chips, *etc.*) to equipment (switches, routers, *etc.*) to infrastructure (cable networks, towers, wireless networks, satellites, *etc.*) to products and services (cell phones, wireless email, high-definition television, *etc.*). Where a company fits along that continuum gives us a frame of reference for the questions we need to ask and what we need to do to assess risk.

For instance, over the years, GE has executed numerous transactions with companies at the core end of the value chain, companies that make advanced semiconductors and other electronically engineered inputs that enable the rest of the value chain. This includes companies that produce specialty materials that enhance the performance of semiconductors and storage devices to companies that possess intellectual property that allows broadband signals to penetrate buildings without losing performance. Over those same years, the group has financed numerous companies at the infrastructure end of the value chain. The differences between chip companies and tower companies are many. Their competitors are different. Ongoing convergence affects them in different ways. The core dynamics of their businesses are dissimilar, and, most likely, their managers and executives are different. Therefore, it is possible to view these companies distinctly and customize the underwriting and risk analysis accordingly.

We capture as much data and information as possible to better analyze a borrower's business, projections and risks. One aspect of this process, which we call triangulation, demands more than one (and preferably three or more) information measurements to support the analysis.

For example, when analyzing financing requirements for a tower company, it is essential to get a handle on demand for tower capacity and the existing and future density of tower coverage. The first data point is pretty obvious: Find out the number of new towers forecasted by the wireless carriers. This figure is often supported by capital expenditures provided by the wireless operators. The second

data point would be a technical model that forecasts demand based on key assumptions, such as growth in minutes of use; increase in the number of subscribers; the amount of new revenues derived from new equipment required at the towers; reduction of tower demand based on technology efficiencies; decreases due to carrier consolidation; and moving sites to nontower sites, such as rooftops. The third group of data points could include industry analyst forecasts, tower company forecasts, equipment vendor forecasts and an understanding of companies in our portfolio. By requiring three data points, we can get a good perspective on a company's plans, numbers and financing needs.

## A Hotbed of Convergence

The question of traditional and nontraditional competitors is particularly pertinent to media and communications. One view of convergence is that it's a free-for-all out there. Media and communications companies that historically had distinct, identifiable businesses are invading the value-chain territory of other media and communications companies. And *vice versa*. Take wireline telephone companies, for instance. They face a frontal assault from wireless service providers. The number of fixed lines is declining, and consumers are substituting cell phones for home lines. Even worse for fixed-line companies, Voice over Internet Protocol (VoIP) is taking hold, allowing consumers to circumvent phone line, switched networks altogether. Now that it has purchased the Internet phone company Skype, eBay might be considered an old-line phone company's newest competitor.

Consider cable companies. Cable operators have long been at the forefront of spreading the digital revolution. Most operators now offer, besides an ever-increasing array of channels, a menu of two-way digital video products such as video-on-demand and pay-per-view. In addition, since they pushed broadband connections to users, they offer high-speed Internet services. As a natural consequence, many cable operators are pushing into VoIP, a direct threat to telephone companies.

Big telephone companies, however, are not sitting idly by while cable companies devour the value chain. They are spending to upgrade or replace wire networks, and they are aggressively selling digital subscriber lines (DSL) to speed up Internet services. Some

are pushing into video. Verizon has started offering video services and has recently filed applications to offer television services to a handful of towns, thereby serving up a direct challenge to incumbent cable operators. Finally, wireless service providers plan to send television programming through the airwaves directly to your wireless phone or other device.

The telephony/cable space is a hotbed of convergence, to say the least. From a lender's perspective, incorporating the threats posed by nontraditional competitors is critical to proper underwriting in a converging industry. Understanding the technical details, such as the status of infrastructure build-out for each competitor, is an important underwriting criterion.

### Emerging Technologies and Early Stage Financing

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As for disruptive technologies, technological advancement is a consistent theme in the media and communications industry. This is not disruptive in a negative sense, however. Disruptive technologies are emergent ideas and advancements that change the way media and communications businesses operate. For example, devices such as TiVo change the way people watch television, iPods and satellite radio change the way people listen to music, and wireless technology is changing how and where people receive information. Hence, it is essential that financiers and lenders to the industry have insight into technological change and a perspective on how changes will ripple through the media and communications value chain. Staying on top of fast-changing technology in every segment of the industry is overwhelming. No one person, even in a group of the savviest financiers, can be all-knowing and all-seeing when it comes to technology.

To gain insight and perspective, we look at technology from the standpoint of computer architecture, boiled down to chips, boards, boxes, infrastructure and functions. This approach helps us better understand new devices and their inherent complexities. Satellite, for in-

stance, is a collection of communications chips, boards and boxes that happens to orbit the earth. Similarly, a cell phone is simply a collection of chips and boards you can hold in your hand. In either case, by focusing on discrete elements of electronic architecture, one can discern how new technology enhances the power or performance of that device and how businesses up and down the value chain might be affected. That can be added value in making financing decisions.

Regarding venture-stage financings, credit can and is extended to prerevenue companies in the media and communications space. Obviously, we recognize that such relationships are of higher risks, so transactions may take the form of smaller loans with shorter maturities. Rigorous analysis of these borrowers is combined with a deeper understanding as to whether such companies have raised professional equity and have a long enough cash runway to carry them partly through the loan term. In many cases, these companies are pushing the technological envelope. They are the ones changing the chips, boards and boxes that will catalyze changes in the communications industry in the future. Working with these companies provides firsthand perspective into the industry value chain.

### Speak Borrowers' Language

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GE's global media and communications unit leverages its technical expertise beyond underwriting and into marketing. It is essential to speak the same language as potential borrowers and to exhibit a technical understanding of their businesses. Similarly, with existing clients, we continue to interact with management long after the loan is made. For private equity firms, who are showing growing interest in media and communications companies, we offer expertise of benefit to them and to their leveraged portfolio companies. Exposure to companies all along the media and communications value chain allows us to bring knowledge of best practices to the table—a hallmark of GE management. If best practices are followed and inefficiencies are wrung out, the enterprise value should grow—a satisfying result for all involved.

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