

TVN plc – the meaning behind the IPO

Swap or How to regain cash

In the swap process, the ITI Holdings (ITI) shareholders will get cash plus TVN shares in exchange for 59% of their shares. A considerable share package is sold not only by the BRE Bank, but also by the ITI founders. As a result of the process, the ITI founders will obtain mainly cash (64% of the swap value that will state the whole income from the TVN IPO) and TVN shares (36% of the swap value).

The whole income from the TVN IPO will reach the current ITI shareholders – this is the arrangement behind the IPO. As a result, it is not even the ITI Group that would register income from the offering as much as the ITI shareholders now withdrawing their assets or limiting their engagement with the company (including its founders).

The ITI shareholders: founders, the BRE Bank and other parties, usually linked to the ones mentioned before, will get money from the swap from N-Vision, a company that sells TVN shares during the IPO (64% of the swap value and 8.6m TVN shares, which amounts to 36% of the swap value).

Two thirds of the swap value means cash from selling 15.9m TVN shares through the IPO. One third of the swap value equals to 8.6m TVN shares that will be handed over to the ITI shareholders.

The TVN IPO guarantees a withdrawal from the investment for ITI. Money from the public offering will be transferred to the BRE Bank as well as to accounts of former ITI owners, including its founders or ITI founders' companies. What is the swap value then on the part of the ITI founders? This has to be a huge amount as the swap includes 59% of all the ITI Group shares, with the ITI founders having possessed and controlled over 50% of the shares.

Who is the owner of bonds issued by TVN?

It is even more interesting as the bondholders are able to submit their bonds for redemption in case of a “change of control of the Issuer”. Such a phrase is a part of the bond issue agreement, page 92 of the Prospectus: “In case of a change of control over the Issuer by, among others, selling its whole property or a considerable portion of it, merger or another form of restructuring, the TVN Finance Corporation would be forced to submit an offer of redemption for all of its bonds at a price of 101% of their face value plus the accumulated unpaid interest to the Issuers”.

Yet only on page 284 of the Prospectus and in a chapter devoted to financial reports can one find more information on the bond issue agreement. It is quite curious that the conditions concerning the bond issue agreement **with regard to submitting bond for immediate redemption** are not included in a chapter entitled “**Description of significant agreements**”.

Only in the financial report, page 284 of the Prospectus, 19d note explaining a balance sheet figure can one read the details of the key liability of the Issuer:

“The bonds include an option for immediate redemption that can be effected at a price of 101% of their face value in a case of occurrences related to change of control, defined as follows:

- *a person different from the Allowed Proprietors becomes an owner in their own interest of more than 35% voting rights attached to the company shares entitled to voting*
- *the attested members of the Board cease to constitute a majority of the Board of Directors*

- *the company sells a majority of its assets*
- *the company is liquidated*
- *the company ceases to hold 100% of the Issuer (TVN Finance) shares”*

Who are the Allowed Proprietors for TVN shares according to the bond issue agreement clauses? And who are the attested members of the Board of Directors?

The TVN Prospectus provides no answer for such questions, though that is really basic information, taking into account the corporate rights of the TVN shareholders and the fact that TVN debt from the bond issue amounts to 960m PLN and almost 70% of the balance sum. The Prospectus contains no information as to conditions included in the bond issue agreement that can result in immediate redemption of the bonds. Moreover, the appropriate part of the Prospectus carries no information on the Allowed Proprietors or attested members of the Board either. Some important details regarding submission of bonds for immediate redemption can be accessed only by reading a note explaining a balance sheet figure.

The conditions included in the bond issue agreement suggest that parties linked to ITI owners can serve as buyers of the bonds, including BRE Bank. What other sense would the clause appointing an Allowed Proprietors clause in the bond issue agreement have?

If the bondholders are somehow linked to the ITI shareholders, their decision to withdraw or reduce input in company is even more worrying. **The whole income from the TVN IPO will reach the current ITI shareholders.** It seems that the ITI owners, and possibly at the same time TVN bondholders know the company they are withdrawing from really well.

An “acquisition of financing” service

TVN paid 75m PLN for “acquisition of financing” through a bond issue. This number is not included in the balance sheet, as it is treated as delayed cost of obtaining income according to an “amortized cost evaluation principle”. Yet it is something uncommon as the abovementioned value should have been covered under long-term liabilities and at the same time under a special item within assets, indicating the value of “acquisition of financing” and a note **explaining the character of this asset and its future settlements**. [It is clear that many people evaluating the balance sheet would immediately decrease the balance sum by the value of such an asset... then the debt level may scare away even the most die-hard optimists.] The auditor PricewaterhouseCoopers having agreed to throw the amount of 75m PLN away from the long-term net liabilities is a case that should be tackled at least through a proceeding within a body uniting the auditors and setting standards of decent practice.

The “remuneration” for organizing the financing contains another piece of information. Who received the 75m PLN commission?

The bonds issued by TVN bear high risk linked with the financial standing of the Issuer. Investors interested in risky bonds were found and at the same time a commission was paid for “organizing the financing”. For managing a public offering of 1bn PLN worth of bonds costing 75m? Does preparing a Prospectus for bond issue at the Luxembourg stock exchange cost that much? Rather an expensive service for such a cheap stock exchange.

Another risk factor might be checking in the future the circumstances of the TVN bonds issue and the links of parties that received commission for organizing the financing with the decision makers that allotted money for such risky securities. Such a procedure may be started as a routine action by unit combating money laundering and bribery to the detriment of companies.

TVN – what business is it?

TVN has been present in the Polish market since 1997 – a pretty long time. For the last three years, the market share remains more or less constant (with daily nationwide viewing figures ranging from 16.4% to 17.9% according to AGB Polska). If the business is so vivid, why did the owners decide to convert 59% of the shares, two thirds of them directly to cash? One may say that they have decided to partly exchange share in ITI for shares in TVN, but they did it only for one third of the whole operation value, while they had an adequate share in TVN through ITI as well, with TVN being a key asset of ITI.

The swap is an elegant way to withdraw from investing in ITI.

If the present ITI stockholders (including founders) were to receive only cash for their share in ITI directly from the money gathered by the TVN IPO, the offering might not convince even the most optimistic investors. Moreover, the offering would have had to be much larger as all the money is already geared to buying ITI shares from the owners.

The business run by ITI and TVN is visible on their balance sheets. Both companies are well established in their markets, yet the debt levels remain alarming. The parties that granted credit to ITI and TVN decided to exchange liabilities for shares – this way the BRE Bank became a 10% shareholder of TVN. **Both companies are still extremely indebted in spite of the former debt-share swap.**

It is quite clear that the “financial shareholders” of ITI have had enough of such business and see the TVN IPO (and more precisely: the money of TVN happy new shareholders) as a way to get some of their money back. The balance sheet structure of both companies must have pointed to the “financial shareholders” of ITI that it was high time convert shares to cash and abort the investment.

Withdrawing from TVN24

Withdrawing from ITI by means of swap is one of the ways for the ITI owners (including founders) to regain their money.

The other way is to withdraw from TVN24. Before its IPO, TVN took 80,685 shares in TVN24, paying 168m PLN for them. Where did the money go? A 17.5m\$ debt was repaid and the remaining shares were bought back for over 100m PLN for the purpose of redemption. ITI TV Holdings and ITI Impresario received 100m PLN in cash, the amount agreed between TVN and TVN24, with the TVN Board of Directors maintaining close relations with TVN24 owners.

Bonds for bonds

I have already mentioned the case of charming booking the 75m PLN “acquisition of financing”. Two questions have been approached: the way of booking the cost and the person that received the commission. The latter is of crucial importance, as it reveals more about the bond issue details, a key contract for TVN. Thus it is even more curious that the contract details, including the conditions for immediate redemption of bonds, were described so briefly in the TVN Prospectus.

Looking through TVN bonds quotations from the Luxembourg stock exchange one can not help thinking that the bonds were bought by just a few parties rather than the so-called market. Link to quotations: <http://www.polandsecurities.com/tvnbond> The last transaction is a month old,

with the graph showing not even one more in the period from April to September 2004. Boasting about successful placement of the issue may be a bit off the point here. One would rather suspect that the bonds were bought by parties linked to ITI, such as the BRE Bank. The bond issue had an effect of hiding the parties financing TVN and ITI. In case of credits and loans hiding would have been much harder, even more so in cases of a variety of links between the creditor and the issuer, such as the former being an important shareholder of the latter. The nonexistent liquidity of bonds at the Luxembourg stock exchange once again draws attention to the commission assigned for “acquisition of financing”. Drawing up the Prospectus could not have cost 75m PLN.

The TVN bond issue prospectus is interesting with respect to aim of the issue and use made of gathered capital. TVN acquired 1bn PLN for its bond issue, but assigned over half of the sum to buy a bond issued by ITI Media. Then ITI Media purchased 30.4% of TVN shares from SBS Broadcasting Ltd. with the money acquired from the issue. This means that, in a sense, TVN purchased 30% of its own shares paying 550m PLN, a value twice as high as its shareholders’ equity. Why then was it TVN that bought the bond issued by ITI Media? Apparently ITI Media could not have found a better way of financing the purchase of TVN shares from SBS, and as contracts remain, SBS requested the repurchase. Resultantly, TVN mutated into an investment fund, starting from a TV station, currently with 40% of its assets in ITI Media. And one has to add, that the assets are burdened with a very high debt, with the shareholders’ equity constituting merely 15% of the company assets. TVN became an investment fund that invested 40% of its assets in a bond of a company, whose value and liquidity depends ...on the financial standing of TVN.

In the TVN prospectus we can read the following about ITI Media (page 121):

“On 2 December 2003, the Issuer purchased a bond issued by ITI Media with a face value of 131,561k Euro. ITI Media is a holding company, with a portfolio of other ITI Group media companies’ shares and securities. (...) The ITI Media bond is included in the most favored partner clause compared to other current and future liabilities of ITI Media. The interest on bond will be calculated according to a 10.03% effective annual interest rate and are to be paid on the redemption day. The effective interest rate amounts to 10.03% and the redemption date is 15 January 2014.”

If ITI Media has more diversified assets than only its own shares purchased from SBS it becomes in a way more credible and able to redeem its own bonds. Yet there is one problem: ITI is equally deep in debt, or even, as the Moody’s report on TVN suggests, its credit rating may be weaker than that of TVN: **“TVN IS OWNED BY ITI GROUP – A WEAKER CREDIT** Moody’s notes that TVN’s parent company, ITI Group, recently concluded a restructuring of its debt with BRE bank, its main lender. Notwithstanding the restructuring, Moody’s views ITI Group’s credit as weaker than TVN’s”

One has to make an assumption (and one that borders certainty) that other ITI Media assets can be under pledge, just as the TVN shares purchased from SBS securitize the ITI Media bond issue with TVN.

If all the ITI Media assets already are pledged to the company’s lenders, the value of ITI Media bond as one of the TVN assets may be questionable.

What security is provided by lien on 30% of shares in TVN? And what could happen if the shares are not worth the assumed 550m PLN, but only 250m PLN? The TVN assets would have to be diminished by 300m PLN with a resulting shareholders' equity of -80m PLN – a bankruptcy. And then in fact the shares cannot be worth 250m PLN – if it is a bankruptcy, they are worth 0 PLN. Such is a result of correlating TVN assets value... with its TVN stocks value – if a slump in share prices is recorded, it soon turns into frantic plummeting. How many people would see a 550m PLN estimate of a 30% share in TVN as undervalued? The conclusion has to be drawn by each investor and TVN creditor. qq

Hence it is not strange that after TVN having described the aim of bond issue to be the purchase of ITI Media bond in its Prospectus (and with ITI Media planning to buy a 30% in the issuer from SBS) no external investors might have been found willing to buy such bonds. [Even though liabilities are favorable ahead of shareholders when it comes to dissolution...]

It is not strange either that the income from the TVN IPO **is to serve the current ITI shareholders to withdraw from the investment** and regain a portion of invested money (e.g. BRE Bank).

Who is the target of the IPO?

Is that really the foreign investors? The tranche size may be changed freely and the whole offer for foreign investors may soon turn into an “image of the offer for foreign investors”.

With rating lowest in their investment category:

Standard & Poor's: B-

Moody's Investors Service: B3

and financing by bond issue with an interest rate of 9.5% denominated in Euro it may be really hard to attract the foreign investors.

The TVN bonds were most probably not purchased by a wide range of investors, in spite of high bonus for issuer standing. Apparently the risk was much higher. Why should the foreign investors purchase the TVN shares now, at a price ten times higher than the book value, astounding debt and a financial history of debt-share bailouts?

The real target of the TVN IPO becomes understandable when one looks at the distribution channels, such as CDM Pekao (market leader with regard to number of customer service points) and BM BPH PBK.

Many newspapers now carry a large ad of the TVN IPO, the same happening with radio programs. Such kind of advertising campaign, however, seems more suitable for selling a washing powder or a three-colored toothpaste.

In addition, the Polish press ads were mentioned earlier, and my probably correct assumption is that their target does not include... foreign investors.

And in fact are the investors (this time the domestic ones) so easily convinced by press ads?

The option for early bond redemption

An option for early bond redemption worth 7.7m PLN appeared in the TVN assets (31 June'04)

1. Why did the value appear as late as in 2004? The issue took place in 2003, and the option appearing out of nowhere (why not in 2003?) raises suspicion of inflating the 2004 financial result by 7.7m PLN. qq
2. What is the use of calculating the value of such an option? First of all, the issuer would have to have money for early redemption combined with such an intention. To be precise, a hypothetical value of such option could be calculated starting at a point in the future when the issuer foresees acquiring sufficient financial means for bond redemption. The discounted difference in debt servicing costs can be expressed within the option value starting from that point, whereas in fact the issuer gave no advance notice of plans to use the option. qq

What is the meaning of calculating early bond redemption? Let us assume for a moment that TVN issued junk bonds with even worse standing and an interest rate of 12% instead of 9.5%. But then the value of an option for early bond redemption (assuming all other conditions the same as with the 9.5% bonds) would... rise significantly. The bonds are junk bonds, the issuer standing worse, servicing costs higher... but the option value jumps (as it is based on difference in interest when redeeming early in comparison to redemption as scheduled). And, above all, point 2 is important – the issuer has to have money for early redemption.

Program assets

This item gains 18m PLN in 2004, with a new subitem of news archives appearing, worth 14m PLN. Who concludes the program asset value assessments and why do the news archives appear on the list? One knows that each TV station uses mainly its own archive, but TVP or Polsat (other major Polish TV stations) are not likely to pay much for access to the TVN archive – most probably it is TVN that would have to pay for access to the TVP archives. So why such a value and why does it appear in 2004 qq?

SBS, TVN and Jan Wejchert

What is the situation of the TVN shares, then? ITI was obliged to repurchase the 30% share in TVN from SBS for 550m PLN.

Jan Wejchert was one of the SBS Broadcasting Ltd. (Luxembourg) Managers, and the SBS, while purchasing TVN shares transferred 33,333 options for its own shares to the members of the ITI executive committee, meaning that the people managing ITI received remuneration for the transaction with SBS from the same SBS. Whose gain was the priority of Jan Wejchert and other people concluding transactions involving TVN shares, if they received the options?

10% of 550m PLN annually

That is the amount by which (excluding the exchange rate variations) the TVN long-term asset: bonds purchased from ITI Media is increasing annually. ITI Media pays no interest yet, so that the interest is accumulating... until 2014. Below we can see the book increases in bond value:

Date	Bond value (in Euro)
2.12.2003 (date of issue)	131.561
2.12.2004	145.375
2.12.2005	160.640

2.12.2006	177.507
2.12.2007	196.145
2.12.2008	216.740
2.12.2009	239.498
2.12.2010	264.645
2.12.2011	292.433
2.12.2012	232.139
2.12.2013	357.068
15.01.2014 (date of redemption)	361.546

Source: Issuer

BRE Bank in the TVN IPO

In a chapter “Factors influencing sale price” (page 14 of the Prospectus) one may read:

“The price range or its change will be determined by the introducing broker with unanimous consent from the remaining shareholders, that is TV Tech Investment 1 and Strateurop International and in agreement with the major co-managers.”

This means that the price and the whole offering depend on the decision of BRE Bank (TV Tech Investment 1). Yet the shares are brokered by N-Vision, not by BRE Bank, which appears in a mysterious manner. Is its engagement in TVN and ITI that heavy?

BRE Bank cooperated with the issue but was not recorded as a party taking part in drawing up the Prospectus.

BM BPH PBK and CA IB run the race

BM BPH PBK seems as if it wanted to resemble the PKO offering and attract the recently rewarded queue combatants (the PKO Bank offering, was administered by the Polish Treasury on a first-come-first-serve basis and low priced). The credit offer for TVN share purchase is quite praiseworthy, as usually the product is created as an answer to an existing demand, but sometimes it is the other way round. It is interesting, which of those cases we are seeing now. Will the offer make impress the individual investors? May they not have to experience an overly emotional future with the purchased shares...

It would be nice if BM BPH PBK offered some more information on its background.

On the other hand, I wonder if the following ad saying: “Television is a good business. Invest in TVN shares.” does not breach the law regulations. Is an investment broker still able to issue free recommendations in such a form, taking into account the regulation on financial instruments and their issuers?

BM BPH PBK is one of the TVN most generous creditors. CA IB, linked to the former one, prepared the TVN Prospectus. It would be at least polite to inform customers about such relationships, even more so in the context of credit action and purchase recommendations.

The TVN and ITI Service management contract

A comprehensive quotation from the prospectus reads: “On 22 July 2004, the Issuer concluded a contract with ITI Services, the ITI Group member company, according to which ITI Services would provide the Issuer with managerial and other services, including areas such as sales, supply management, market and branch analysis, HRM, accounting, financial management, legal assistance and investor relations.

Range and quality of the abovementioned services are to be analyzed by the contactors on a yearly basis. In return for the services offered, the Issuer is obliged to settle a yearly payment of 3.000k Euro due to ITI Services in the given year, in compliance with the next paragraph. A reservation would adjust the amount according to the warranties issued by ITI Services.

The Parties ruled that the payment for services due in 2004 will be decreased by amount paid by the Issuer in the period from 1 January 2004 to 22 July 2004 to JHH Exploitatatie Maatschappij B.V. and FFMP Finance Holding B.V. or any other company belonging to the ITI Group for a warranty issued by the ITI Holding to secure payment of licensing fees for programs used by the Issuer.

Moreover, ITI Services made a commitment included in the contract to issue warranties and provide other kinds of financial and similar support, so that the fulfillment of the Issuer's and its dependent companies' liabilities is secured. In return, the Issuer is obliged to settle a yearly payment amounting to 3% of its and its dependent companies' liabilities secured by the warranties issued by or for ITI Services".

Does TVN not have its own management, so that it has to contract out the management functions to the ITI Group at a cost of 10m PLN a year?

There is a multitude of agreements connecting TVN with various ITI Group companies and the ITI staff can face difficulties while determining whose interest to serve first... If Adidas provided consulting to a football team regarding the choice of footwear and sports gear and at the same time supplied the time with such products, few of us would find payment for consulting services to be the most appropriate option. Here I will provide no judgment on the character of mutual provision of services and advice in the TVN case, as probably everyone has his or her own opinion, basing on their unique experiences.

One has to remember, however, that subjects acting within a group find it considerably easier to manipulate financial results, the phenomenon being confirmed by charges against companies applying the so-called transfer prices. The manipulation can also take form of result inflation ahead of an IPO.

Railway for sale

Target group switches over to the Internet

The ITI Group owners' ideas of attracting advertisers in 2005 and the following years are at least questionable. The target group of 16-to-49-year-olds living in large cities is more likely to have a habit of switching the computer on, or even of not switching it off, than one of turning the TV on. Already a considerable portion of them can be suspected of such habits, being at the same time the most attractive segment of the target group. So with the current rate of the Internet spreading in Poland what kind of member of this group would be a frequent viewer in two years' time?

Why is the target group running away from television? News, entertainment, movies – they can choose according to their preferences. The quality of movies downloaded from the Internet is constantly increasing and soon it can surpass the televised original, with faster connections allowing for increase in resolution. What's even more important, in the Internet one can find movie hits – often much earlier than their official Polish cinema launch dates. The attraction of forbidden fruit works here as well, adding to the glamour of movies obtained through P2P services. And, finally, the vast selection from an enormous movie library... all those factors add up to the reseat the target group towards their computers rather than TV sets.

News is an Internet specialty too, with everyone enjoying whatever they need. The times of waiting for a TV program and adjusting the day schedule to what is on are long gone. That's why traditional television, such as TVN, seem to be a long forgotten hit, a vinyl record instead of a DVD.

The railway used to be an important invention, with people waiting at the stations for the train to arrive. Yet nowadays, in the age of widespread car ownership, each individual can decide where and when to go. And when it comes to the Internet – there are even no traffic jams. The television definitely had a great impact on social development, just like the railway – but now it has to yield the palm to the Internet.

The advertisers quickly retreat from commercials.

Firstly, the commercials are not going to have many viewers – as they will be staring at their computer screens at the time. Secondly, the availability of animation and interactive advertising in the Internet will depreciate the message of commercials. The value of TV advertising is likely to plummet even faster than the number of viewers, and with the current results of TV stations not translatable into their future results it will not take long for the market to react to the discrepancy. Bankruptcy awaits a considerable portion of all TV stations, starting from the most heavily indebted companies.

Who will eat the advertising pie?

Or else: what sites will rejoice with mass visits? Rich content is needed to attract the internet users, with type of the content important to the advertisers apart from sole volume. Who can offer rich content then? Services that either possess vast resources or encourage user expression. The highest content reserves are owned by daily newspapers, priceworthy for the advertisers on a basis of high content quality and reaching the target recipients as well.

Daily newspapers ready with their archives are likely to take over a considerable segment of the advertising pie. They have a wealth of means to attract visitors to their web pages, and with sound management they can not only profit on internet advertising, but raise their issue volume as well. As the Internet makes the need for information more common, it can be used to enhance susceptibility to buying newspapers. The paper edition is not a direct competitor of the Internet version, being a different form of communication. The editorial staff have enough resources to attract the surfers at the same time shaping its internet and analog presence. Consequently, the internet-based daily newspapers will take over a considerable segment of the advertising pie.

Summary

What assets does TVN have?

The highest value on the balance sheet stands for the ITI Media bonds valued at 145m Euro dating on 2 December 2004 (on 2 December 2003 it was 131m Euro, so the rise amounted to 10%...). This part of assets is 'working' with a profitability of 10% annually, being the interest added to the asset value (+/- exchange rate variations).

Another valuable special asset of the TVN group is the company consolidation value of 141m PLN, which is the difference between the TVN payment for TVN24 and Wisła TV shares and the companies' shareholder equities (taking into account the amortization). This one is equally interesting an asset as the previously mentioned bonds.

Another significant asset reads: program asset value, an item that should be a part of a television station balance sheet, but care should be taken not to overlook such assets' type and mode of their coming into being.

All those assets, exactly as they are, are covered by the TVN group shareholders equity only up to 15%. The most stable part of the balance sheet are the liabilities and liability servicing fees, such as for example the debt related to issued bonds amounting to 1bn PLN with its 9.5% interest rate settled in Euro for TVN, as well as other liabilities. If the shares of such a company are of interest to anybody, one can buy them now, with widespread advertising being made not only by the seller.

Jaroslaw Suplacz

28 November, 2004

© POLANDSECURITIES.COM

Disclaimer:

Content of the above Report cannot be considered to be a recommendation nor interpreted as investment or financial advice. In particular, the Report is not a recommendation for buying or selling of securities nor for abstaining from transactions involving such securities. The Report should be treated only as a systematic collection of information and opinions.