Telecom moves to a holy trinity

Market Call: Neeraj Monga of Veritas

Mark Evans, Financial Post
Published: Wednesday, June 8, 2005

Over the past 18 months, Canada's telecommunications landscape has changed dramatically through a flurry of major transactions.

This saw Manitoba Telecom Services Inc. acquire Allstream Inc. for $1.7-billion; Rogers Communications Inc. buy Call-Net Enterprises Inc. for $338-million and Microcell Telecommunications Inc. for $1.4-billion; and Bell Canada pick up the Canadian assets of 360networks Corp. for $275-million.

Neeraj Monga, an analyst with **Veritas Investment Research**, describes this as a transition from "The Dirty Dozen" to the "Holy Trinity." And he believes there are a few more transactions left in the pipeline that, at the end of the day, will see Rogers, Telus Corp. and BCE Inc. emerge as the dominant communications and entertainment players.

"BCE has the balance sheet, Rogers the momentum and, increasingly, Telus the cash flows to make bold moves, and we see the glory days of cozy oligopolies emerging once again," he said in a recent research report.

If all the mergers and acquisitions pieces fall into place as **Mr. Monga** expects, Telus and Rogers to be the big wheeler-dealers. Telus could acquire MTS and Shaw Communications Inc.'s Star Choice satellite-television business, while Rogers could solidify its national television plans by acquiring Shaw's cable assets, and boost its telephone business with the purchase Primus Telecommunications Canada Inc., which has 900,000 long-distance customers and 40,000 local phone subscribers.

Mr. Monga's thesis is based on the belief that bigger will be better. "In this interplay of technological substitution, digital convergence, bundled offerings and the migration of the entire industry to a single IP-based platform, with no sustainable technological advantage for any of the players, scale of operations attains paramount importance."

At the heart of this investment analysis of the $33-billion industry are two key issues: the growth of Internet protocol-based networks that can deliver applications and services to millions of consumers, and the popularity of triple-play and quadruple-play bundles that provide discounts to customers who purchase a variety of services from a single supplier.

This means the most competitive and successful companies will be those that run extensive high-speed networks and have the product portfolio to offer bundles. BCE can already provide consumers with a quadruple-play of local phone, wireless, high-speed Internet and TV services, while Rogers will be able to do so in July when it launches a cable telephone service. Telus is currently running a pilot project of an IP-TV service.

Mr. Monga said Telus will have to decide whether it wants to be a national player and become a member of the "troika" with Bell and Rogers. It can either "dither and dawdle" or it can be aggressive and make a bid for Shaw's satellite-TV business.

"Telus needs the capability of delivering at least two consumer services on a national basis to remain a strong contender and competitor to BCE and Rogers," he said. "[The] acquisition of

Star Choice will instantly provide Telus an entry into the entertainment segment."

Mr. Monga does not believe BCE is interested in acquiring Shaw because it already owns a satellite-TV business, BCE ExpressVu, and BCE will likely want to focus on its strategy to offer television service to 1.2 million households in Ontario and Quebec over its high-speed network. To expand this network to handle TV service, BCE is spending $1.2-billion over the next three years.

This means Telus will likely make a joint bid with Rogers for Shaw. Telus will keep the satellite-TV business while Rogers will get Shaw's cable operations. At the end of Shaw's fiscal second-quarter ended Feb. 28, the Calgary-based company had 2.13 million cable customers and 829,650 satellite-TV subscribers.

Mr. Monga expects Telus will also make a bid for MTS within the next 18 to 24 months. He believes, however, MTS will be sold at a lower price than its current valuation because MTS's Allstream business will continue to see lower long-distance revenue and receive less data traffic from customers such as Rogers, which plans to transfer $40-million of business to Call-Net from Allstream.

It is unlikely Telus will make a run at MTS until at least next year. This is due to a deal last year that saw BCE sell its stake in MTS to MTS. It includes provision that entitles BCE to a premium payment if there is a change of control before 2006. As a result, **Mr. Monga** does not expect Telus to pursue MTS until the clause expires.
When the dust eventually settles, he believes the telecom market in five years will see:

- Rogers own a coast to coast cable network;

- BCE operate a telephone network operator from Ontario to Atlantic Canada selling TV services, and a satellite-TV operations supplementing efforts west of Ontario; and

- Telus having a satellite-TV operation that will let it complete in quadruple play market west of Ontario.