

# Canadian Incumbent Telcos - Trend Changes



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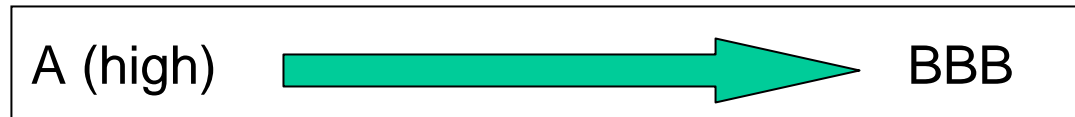
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# Negative Trend Rationale

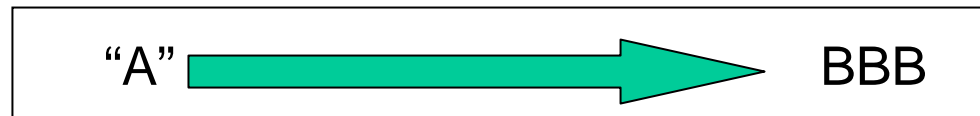
- The top end of the credit rating range for incumbent telcos is becoming difficult to maintain at current levels, attributable to:
  - Shifts in the overall Canadian telecom sector relating to expected changes in the competitive environment
  - With the landscape becoming increasingly uncertain, DBRS believes *business risk* will increase for the Canadian incumbent telcos as a result of:
    - Heightened competition for consumer voice services with cable operators launching services
    - New technologies that allow competitors to circumvent the incumbent telcos' historical last mile access advantage (cable broadband, wireless)
    - Telcos shifting revenues towards growth services where they may not be able to enforce pricing power and generate EBITDA margins greater than 40% (video, broadband)

# Canadian Incumbent Telco Rating Range

Previous Rating Range



Likely Rating Range



# Local Consumer Voice Competition

## **Bell Canada's Local Consumer Voice Service Competitors:**

- Call-Net (Sprint Canada)
- Vidéotron in Québec has launched; aggressive pricing
- Rogers Cable and Cogeco Cable expected to launch in 2005
- Other VoIP operators to a lesser degree (e.g. Primus, Vonage)

## **Aliant Telecom Inc.'s Local Consumer Voice Service Competitors:**

- Eastlink Communications (Bragg Communications)
- Rogers Cable expected in Atlantic Canada in 2005/2006
- Other VoIP operators to a lesser degree (e.g. Primus, Vonage)

Local line relationship is critical to bundle additional services such as broadband, wireless, and video.

Competition in local voice services differs from previous structural changes such as the opening of long distance competition, where local service relationship was maintained.

# Response of Incumbent Telcos

- Canadian incumbent telcos have positioned themselves well given the declines in local and long distance voice revenues:
  - Movement into growth services such as wireless (EBITDA margins > 40%)
  - Availability of video product (owned satellite/expected terrestrial launches) and increasing broadband penetration
  - Cost reduction initiatives and transformation to an all IP network
- However, cable competitors will also have their own “triple play” and even “quadruple play” offerings to counter the telcos’ bundling efforts
- DBRS will monitor the ability of the incumbent telcos to bundle more customers and mitigate customer churn

# Other Business Risk Factors

- Growth initiatives focused on business IT services
  - Fragmented market
  - Highly competitive due to service aggregators, smaller IT providers, and incumbent telcos competing out of their franchises
- Regulatory Issues
  - Potential negative regulatory decision from CRTC pertaining to VoIP services provided by incumbent telcos in their own franchises
  - Could restrict incumbent telcos' ability to compete

# Bell Canada – A (high), Negative Trend

## **Negative Trend Reflects:**

- Expected challenge in maintaining current consumer local market share of 95.8%
- Acceleration of access line erosion could increase from current levels of 1.7% per year
- Local competitive pressure to begin in 2005 and into 2006
- Financial profile is expected to improve in the near term
  - However, liquidity and coverage ratios may not reach levels of other incumbent telcos rated A (high) by DBRS
- Further debt reduction is also somewhat tempered by high dividend payout distributed to BCE to support its financing requirements

## **Rating Supported By:**

- Significant customer connections, including 11.4 million access lines
- Strong brand and customer recognition
- Generation of substantial cash flow from operations
- Size that provides economies of scale with substantial distribution



# Aliant Telecom Inc. – “A”, Negative Trend

## **Negative Trend Reflects:**

- Structural shifts taking place in the Canadian telecom sector, including Atlantic Canada
- Significant customer base erosion in markets where Aliant Telecom Inc. (“Aliant Telecom”) competes with Eastlink
- Competition for local voice service will increase once Rogers Cable launches full-service local voice service in Aliant Telecom’s markets in 2005/2006

## **Rating Supported By:**

- Strong brand and customer recognition in Atlantic Canada
- Good growth in wireless and DSL
- Generation of substantial cash flow from operations, which has supported a strong balance sheet with good liquidity
- Leverage relationship with Bell Canada



# Rating Action Summary

- All of Bell Canada's long-term and short-term ratings have been placed on Negative trend:
  - Commercial Paper and Extendible Commercial Notes → R-1(middle)
  - Debentures and Medium Term Notes → A (high)
  - Deferred Interest Subordinated Debt → A (low)
  - Preferred Shares → Pfd-2 (high)
  - Bell Mobility Cellular Senior Unsecured Notes and Debentures → A (high)
- Also, BCE Inc.'s ("BCE") long-term ratings have been placed on Negative trend
  - Unsecured Debentures → "A"
  - Preferred Shares → Pfd-2
- However, BCE's Commercial Paper and Extendible Commercial Notes have been confirmed → R-1 (low) with a Stable trend
- Additionally, Aliant Telecom's long-term ratings have been placed on Negative trend:
  - First Mortgage Bonds, Medium-Term Notes, Unsecured Debentures → "A"
- As a result, Aliant Inc.'s long-term ratings have been also placed on Negative trend:
  - Issuer Rating → A (low); Preferred Shares → Pfd-2 (low)
- Aliant's Inc. Commercial Paper rating has been confirmed at R-1 (low) with a Stable trend