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# BCE INC.: IN PLAY[1]

*Heather Tobin wrote this case under the supervision of Professor Stephen Foerster solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.*

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By June 22, 2007, much had changed since BCE Inc. (BCE) had held its 2007 business review investor conference call in early December 2006. The company was now “in play” as a potential merger partner or private equity acquisition target. BCE had struggled to keep pace with the rapid development of the wireless market and, in turn, stem the erosion of its traditional wireline business.[2] The leadership team at BCE had committed to go forward in 2007 with a plan to shore up its legacy wireline business and convert 70 per cent of the company’s revenues to growth-based businesses such as wireless, video, data and high-speed Internet by 2009. However, the market remained unconvinced that the leadership team could drive improved shareholder value, as evidenced by BCE stock price performance (see Exhibit 1). With BCE’s stable cash flows, modest leverage, low valuation multiples and no controlling ownership block, private equity investors became increasingly interested in acquiring one of Canada’s most widely held companies.

On March 29, 2007, the Globe and Mail, Canada’s leading national newspaper, reported that one of the world’s most powerful private equity firms, New York-based Kohlberg Kravis & Roberts (KKR), had held informal meetings with BCE executives in the hopes of launching a friendly takeover bid for the company.[3] On March 28, 2007, BCE’s stock price had closed at $30.13[4] per share for a total market value of approximately $24.3 billion.[5] As typical successful acquisitions occurred at premiums of 20 per cent or more, this figure implied an equity purchase price of approximately $30 billion, potentially making this speculated transaction the largest acquisition in Canadian corporate history. In response, BCE promptly filed a press release, stating: “At the request of the [Toronto Stock Exchange] Market Regulation Services, BCE today issued a statement to confirm the fact that there are no ongoing discussions being held with any private equity investor with respect to any privatization of the Company or any similar transaction.”[6]

Although BCE stated further that the company had no current intention to pursue such discussions, the markets were not so convinced. The stock rose 6.4 per cent on March 29, 2007, to close at $32.05, following which the stock began its steady climb as details of the potential transaction unfolded. By June 22, 2007, the stock had reached $40.16 per share, climbing 33.3 per cent from its unaffected price as three

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[1] This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of BCE Inc. or any of its employees.
[2] For additional background information see Ivey case 9B09N015, “BCE Inc.: Facing the Future.”
[3] Eric Reguly and Andrew Willis, “U.S. [private] equity firm stalks BCE, plots takeover,” *The Globe and Mail*, March 29, 2007.
[4] All figures are in Canadian dollars unless otherwise noted. The US/CDN exchange rate as of June 22, 2007 was US$0.94.
[5] Based on 807.6 common shares outstanding as of December 31, 2007. Source: BCE Inc. 2006 Annual Report.
[6] BCE press release, March 29, 2007.

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private equity consortiums were preparing to submit their final bid in what had become an auction process to acquire BCE. (See Exhibit 2 for BCE's stock price and key events.) Further, speculation had emerged that Telus, the largest telecommunications services provider in Western Canada and one of BCE's key competitors, was interested in potentially pursuing a merger.

Each of these respective bidders faced many risks and challenges in their pursuit of the acquisition of one of Canada's largest telecommunications companies. With respect to the private equity consortiums, each would need to value BCE using various valuation methods, including comparable valuation, precedent transaction multiples and discounted cash flow analysis (DCF). To do so, they would need to project the future cash flows of BCE based on its current operations, and make adjustments for any operating improvements or asset sales. They would need to determine the appropriate acquisition premium and, thus, the resulting bid price in addition to considering sources of financing—in particular, the debt-equity mix. Finally, they would need to evaluate the potential exit strategies from their investment in order to assess the internal rate of return (IRR) achievable within their respective holding period. Telus would need to consider the potential strategic benefits that could be derived from merging with BCE in addition to the synergies achievable. Most importantly, each bidder would need to consider the impact of any potential regulatory hurdles, specifically with respect to the *Telecommunications Act of 1993* and the *Bell Canada Act*.

All the bids were to be submitted by 9 a.m. on Monday, June 26, 2007.[7] Should any private equity consortium prove successful, this would be the largest global leveraged buyout in history.

## LEVERAGED BUYOUTS[8]

A leveraged buyout, or LBO, represented the method of acquiring a company or division of a company, whether public or private, using a substantial portion of borrowed money. Such transactions were undertaken by private equity firms. These firms raised pools of capital, primarily from institutional investors, which may include public and corporate pension funds, banks, insurance companies, endowment funds and foundations in addition to wealthy individuals. These investors then became known as limited partners (LPs). The private equity firms, known as general partners (GPs), invested this capital into businesses where they felt there was an opportunity to achieve a significant return on their investment. Returns were measured by the internal rate of return (IRR) or multiple of invested capital and were targeted within a range of 20 per cent to 30 per cent per year over a five-to-seven year period.

In the financing structure of such a transaction, debt would typically account for approximately 60 per cent to 70 per cent of the total purchase price, with the remaining portion funded by equity invested by the private equity firm. The assets of the acquired business would be used as collateral for the loans that were required to purchase the company. These assets then generated cash flow that was used to service the debt interest and amortization payments. As such, although private equity firms undertook extensive due diligence in considering a potential acquisition, one of their most important criteria was the cash-generating capability of the business. Strong cash flow was indicative of how much leverage the business would be able to support as debt repayment was a key driver of financial return. Using a significant portion of leverage allowed private equity firms to acquire a company by funding only a fraction of the overall purchase price with equity. Further, debt holders were generally locked into a fixed return, while equity

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[7] Theresa Tedesco, "Debt Ridden: The story of the BCE deal," *The Financial Post,* September 27, 2008.
[8] Much of the description of LBOs in this section is based on: "Public Value: A Primer on Private Equity," The Private Equity Council, 2007 and "Note on Leveraged Buyouts," Center for Private Equity and Entrepreneurship, Tuck School of Business at Dartmouth, updated September 30, 2003.

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holders received the benefits from any upside upon the exit of the investment; they also took on the risks if cash flows were not as anticipated.

Due to the high amount of leverage, an LBO transaction was often completed by using multiple types of debt obtained through banks and through public and private markets. Senior debt typically accounted for 50 per cent to 60 per cent of total debt and was generally obtained through commercial banks in the form of revolving credit facilities and term debt. Senior debt was usually secured by collateral and had first priority claim over the assets of the business in the event of liquidation. Mezzanine debt, or subordinated debt, typically accounted for 40 per cent to 50 per cent of total debt and was generally obtained through the public markets in the form of high-yield bonds or subordinated notes through a mezzanine fund. This type of debt was generally unsecured and ranked junior to senior debt. It was therefore a more expensive form of capital.

There were three primary drivers of returns in an LBO. The first was de-leveraging, whereby the free cash flow generated by the business was applied to debt repayment. This reduced the debt portion of the capital structure and increased the equity portion, thus increasing the value of the private equity firms' investment. The second was operational improvement. Private equity firms generally brought strong expertise into the sector in which the investment was being made. Through their extensive networks, they could draw on experts to complement the management teams of the company being acquired, which allowed them to effectively determine how to drive revenue growth, cost savings and margin improvement. Finally, a private equity firm could drive return through multiple expansion if that firm could exit an investment at a higher valuation multiple than what it paid for its original investment.

Private equity firms would typically try to exit an investment through three primary methods. The first would be through an outright sale of the entire company or some of its assets to a strategic buyer or to another financial buyer. The second would be through an initial public offering (IPO). While this method may not allow the firm to sell its entire equity stake, an IPO would allow the firm to reduce its exposure and realize a return on a portion of its investment. Finally, a private equity firm could exit an investment through a recapitalization. The acquired company would become re-leveraged, thereby replacing equity with more debt in order to extract cash from the company.

## COORDINATING THE STRATEGIC REVIEW PROCESS

On April 17, 2007, BCE filed a press release confirming that it would be reviewing its strategic alternatives, which included discussions with various Canadian-lead consortiums to explore the possibility of taking the company private. On April 20, 2007, BCE announced the establishment of a committee of independent directors, the Strategic Oversight Committee, to oversee the assessment of company's strategic alternatives. On April 29, 2007, BCE announced its expectation that the review of its strategic alternatives would be completed by the third quarter of 2007. With respect to the discussion of privatization, Committee Chairwoman Donna Soble Kaufman commented:

> The actions taken by the board, management and advisors have been consistent with the goal of creating an open process to surface the highest value available through the privatization option. In doing so, we recognize the challenge presented by the fact that the Government of Canada's foreign ownership rules will limit the role that large, non-Canadian sources of equity can play in enabling this competition. For that reason, our goal from the beginning has been to foster a competitive process by seeking to ensure that no one party is able to assemble a disproportionate

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share of available Canadian equity. In all their actions, the board, management and advisors have followed this principle.[9]

BCE further indicated that all parties wishing to qualify to participate in the privatization process must establish adequate financial capacity to undertake a transaction of this size and complexity. The company confirmed it would open an electronic data room to be made available to qualified bidders. Further, potential bidders would also be required to sign standard confidentiality and stand-still agreements.

## REGULATORY CONCERNS

The industry was governed by The *Telecommunications Act of 1993*, which provided the main framework for the regulation of the sector in Canada. The Act outlined the main objectives of Canadian telecommunications policy, the powers of the government, the Federal Minister, and the regulator, i.e., the Canadian Radio-television and Telecommunications Commission (CRTC). However, Canada was one of a small number of OECD countries that had restrictions on investment and ownership in public telecommunication operators. A combination of direct and indirect restrictions placed a cap on foreign ownership in Canadian telecommunications firms of 46.7 per cent.[10] As such, any bidding consortium would have to ensure significant Canadian representation in order to meet these restrictions under their new proposed ownership structure for BCE.

Although there had been a recommendation by the government appointed Telecommunications Policy Review Panel to remove such foreign ownership restrictions, when asked whether the minority Conservative government would consider removing the cap, Finance Minister Jim Flaherty stated, "There's no intent to change that law."[11]

Further, BCE has its own act of Parliament, the Bell Canada Act, which required a change of control approval. Consequently, a bid could be blocked by the Government of Canada if it was not deemed to be in the best interest of Canadians.

## BIDDERS EMERGE

As the deadline to the bid date drew closer, four contending bidding consortiums emerged, including three consortiums of financial buyers and one strategic buyer.

### Ontario Teachers' Pension Plan

Ontario Teachers' Pension Plan (OTPP)—or "Teachers'" as it was often known—was BCE's largest shareholder, having recently increased its ownership to 50.8 million shares of the company, or 6.3 per cent of shares outstanding, acquiring an additional 8.02 million shares at an average cost of $39.48 per share.[12] This ownership position gave OTPP unique knowledge and expertise into BCE's operations. With $106 billion in assets, OTPP was one of the largest public sector pension funds in Canada, with $6.1 billion

[9] BCE press release, April 29, 2007.
[10] OECD, Regulatory Reform in the Telecommunications Industry, 2002.
[11] Chase, Steven. "Foreign-led telecom bids must obey existing cap, Flaherty says; Minister declines direct comment on potential BCE takeover," *The Globe and Mail*, April 11, 2007.
[12] United States Securities and Exchange Commission, Schedule 13D/A. BCE Inc. Filed June 5, 2007.

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invested in private equity through Teachers' Private Capital.[13] On April 10, 2007, OTPP filed a schedule 13-D[14] with the U.S. Securities and Exchange Commission (SEC) in response to reports that KKR was interested in pursuing a transaction to acquire BCE. This filing confirmed that OTPP held beneficial ownership of more than 5.0 per cent of BCE's shares and noted that "as the Issuer's largest shareholder, Teachers' is closely monitoring developments and is exploring its options."[15] This filing was pivotal as it changed Teachers' position from being one of a passive shareholder to that of an active shareholder, indicating that it was likely assembling a consortium to lead its own privatization effort, thereby pushing the stock to close up 5 per cent per cent that day. OTTP spokeswoman Deborah Allan commented: "We'd like to play a part in BCE's future growth. We're a long-term shareholder. We started buying it just about at the outset [of Teachers' starting its active management strategy in 1991], and we're there for the long term."[16]

OTPP was joined by two leading U.S.-based private equity firms, Providence Equity Partners (Providence) and Madison Dearborn Partners (MDP). Providence specialized in equity investments in media, entertainment, communications and information companies globally. It managed funds with approximately US$21 billion in equity commitments and had invested in more than 100 companies operating in over 20 countries since the firm's inception in 1989. Providence had extensive telecommunications experience and most recently partnered with Teachers' in a bid for Telesat, BCE's satellite services subsidiary, which was ultimately sold to Public Sector Pension Investment Board (PSP) and Loral Space Communications. Noted investments included AT&T Canada, Warner Music Group, Nextel Communications and Eircom, the Irish national incumbent fixed-line telephone company. MDP had more than US$14 billion of equity capital under management and, over the past 20 years, had completed over 200 investments across a broad spectrum of industries. In terms of the communications sector, noted investments included Nextel Communications, Clearnet Communications, Omnipoint Corporation, and MetroPCS Communications.

### Canada Pension Plan Investment Board (CPPIB)

On April 17, 2009, the CPPIB confirmed that it would be partnering with the Caisse de dépôt et placement du Québec (the Caisse) and the PSP, who together would be majority shareholders, in addition to KKR, in the bid process to take BCE private. PSP would later withdraw from the consortium and on June 11, 2007 was replaced by Onex Corp., Canada's largest private equity firm.

This consortium had deep pockets, a strong Canadian representation and extensive experience in the Canadian and international markets. The CPPIB and the Caisse were Canada's two largest public sector pension funds, with $116.6 billion and $143.5 billion in net assets of which $8.1 billion and $16.8 billion were invested in private equities, respectively.[17] In terms of select telecommunication experience, in partnership with Apax Partners, the CPPIB took over German phone and Internet services company Versatel Deutschland in 2005. The Caisse owned 45 per cent of Quebecor Media, which in turn owned one

[13] Ontario Teachers' Pension Plan, 2006 Annual Report.
[14] Schedule 13D is referred to as a 'beneficial ownership report.' According to the SEC, "When a person or group of persons acquires beneficial ownership of more than 5% of a voting class of a company's equity securities registered under Section 12 of the Securities Exchange Act of 1934, they are required to file a Schedule 13D with the SEC. Schedule 13D reports the acquisition and other information within 10 days after the purchase. The schedule is filed with the SEC and is provided to the company that issued the securities and each exchange where the security is traded. Any material changes in the facts contained in the schedule require a prompt amendment. The schedule is often filed in connection with a tender offer." Source: SEC website, http://www.sec.gov/answers/sched13.htm accessed on August 31, 2009.
[15] United States Securities and Exchange Commission, Schedule 13D. BCE Inc. Filed April 9, 2007.
[16] Theresa Tedesco and Lori McLeod, "Teachers' has US$25B for BCE bid: Sources says Citigroup providing financing for pension giant's move," *The Financial Post*, April 11, 2007.
[17] CPPIB as of March 31, 2007. Source: CPPIB 2007 Annual Report Summary. The Caisse as of December 31, 2006. Source: 2006 Annual Report.

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of BCE's top rivals, Videotron, the largest cable company in Quebec.[18] Through its portfolio companies, Onex was one of the largest employers in Canada, boasting a long track record of success with a compounded annual return on its invested capital of 28 per cent since inception.[19] Onex would therefore bring significant execution and operational capabilities to the consortium. KKR had an equally extensive history of activity in the Canadian market and a partnership with the CPPIB, who was one of the largest investors in KKR funds.[20] BCE would be KKR's fifth Canadian deal, others of which had included the purchase of Canadian General Insurance for $160 million in 1995, the $2 billion acquisition of Shoppers Drug Mart in 2000, the $3.1 billion acquisition of BCE's Yellow Pages in 2000 and the $3.3 billion purchase of Masonite International in 2005.[21]

### Cerberus Capital Management

On May 23, 2007, BCE's Strategic Oversight Committee announced that a group led by New York-based private equity group Cerberus Capital Management (Cerberus) had joined the race in pursuit of the privatization of BCE. Cerberus had previously bought telecommunications carrier Teleglobe from BCE in 2003. It was reported that two Ontario pension funds in addition to CanWest Global Communications, one of Canada's leading media companies, had joined the consortium.[22] CanWest's diversified holdings included an extensive portfolio of television networks and specialty channels in addition to one of Canada's largest newspaper chains. It was reported that CanWest was attracted to the opportunity to participate in the BCE buyout to gain access to a number of distribution platforms, such as cellphones and Internet, for its media content.[23] On June 1, 2007, Hong Kong telecom billionaire and Canadian citizen Richard Li confirmed he would be joining the Cerberus consortium through this private holding company Pacific Century. Li brought extensive telecommunications experience and financial backing to the consortium as chairman of PCCW Ltd., the largest provider of communications services in Hong Kong.

### Telus

Industry analysts had long speculated that Telus might consider making a bid for BCE, whether as a partner in a bidding consortium, or independently. It was noted that a BCE-Telus merger would create far greater synergies and greater operational flexibility than a leveraged buyout. Further, it would create a much stronger national telecommunications champion should the Government of Canada chose to amend the current foreign ownership restrictions or permit entrance to foreign operators. On June 21, 2007, Telus announced it had entered into discussions with BCE about a possible business combination. Darren Entwistle, president and CEO of Telus, stated:

> Telus believes the combination of the two businesses would represent a compelling strategic and financial opportunity for all BCE and Telus stakeholders. It would be an all-Canadian solution for

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[18] Andrew Willis and Stewart Sinclair, "Teachers garners support for BCE bid; Institutional shareholders with one-third of stock indicate they will back a takeover," *The Globe and Mail*, April 16, 2007.
[19] Onex Corp. 2006 Annual Information Form. Includes all Onex's substantially realized and publicly traded businesses from inception in 1984 to December 31, 2006.
[20] Henry Sender and Amol Sharma, "KKR, Canadian Pension Funds Are in Talks to Buy Out BCE," *The Wall Street Journal*, April 18, 2007.
[21] Andrew Willis and Stewart Sinclair, "What's Next for BCE?: Private Equity," *The Globe and Mail*, March 30, 2007.
[22] Andrew Willis, Jacquie McNish, Catherine McLean and Boyd Erman, "CanWest joins Cerberus run at BCE; Two Ontario pension funds also bolster U.S. private equity firm's bid," *The Globe and Mail*, May 24, 2007.
[23] Ibid.

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both immediate and long-term value creation, whilst ensuring a vibrant player continues in this increasingly competitive industry.[24]

It was estimated that the combined company could generate between $700 million and $1 billion in annual synergies (or an increase in earnings before interest, taxes, depreciation and amortization, also known as EBITDA) through the combination of each of their wireline and wireless businesses.[25] As such, as a strategic bidder, Telus could likely outbid many of its rivals through a combined cash and stock offer. In determining the maximum amount Telus would be able to pay for BCE, it would have to take into account the value these synergies would create. Excluding the impact of integration costs, $700 million to $1 billion in annual savings in each of the wireless and wireline business lines could amount to as much as $1.4 billion to $2 billion in total synergies. Assuming the combined entity would trade in-line with the forward 2008E Enterprise Value (EV)/EBITDA multiple for Telus of 6.1x (see Exhibit 3), these synergies could create as much as $8.5 billion to $12.2 billion in value. Under BCE's 807.6 million shares outstanding, this scenario implied a premium attributable to synergies of $10.57 to $15.11 per share.

However, the business combination would likely face several regulatory hurdles. Their combined wireless operations would likely have more than 50 per cent of the total national market share, thereby resulting in just two national wireless service providers along with Rogers Communications. Any merger could have to be approved by the industry regulator, the Canadian Radio-television and Telecommunications Commission, whom many speculated would likely raise objections since its stated goal was to increase competition and consumer choice in the telecommunications market. Such concerns would potentially force the combined entity to divest some of their coveted wireless assets, which subsequently may affect the valuation of the new company.

## MAXIMIZING THE VALUE OF BCE

For the past several years, the leadership team at BCE had led an extensive program of cost-cutting in addition to the sale of non-core assets. These initiatives had been undertaken in an effort to create a lean and focused business model that was concentrated on the company's core telecommunication assets. In essence, this was exactly the type of strategy that would be undertaken by a private equity owner. Yet BCE had continually traded at a discount relative to its comparable peers. As such, many questioned the ability of a private owner to extract further value from the company without compromising its ability to remain competitive, or to repay the debt it would be assuming under the LBO.

However, private equity investors saw several opportunities to maximize the value of their investment in BCE. BCE continued to hold several investments outside of its core telecommunication assets that could be monetized. Such investments included its 45 per cent stake in the publicly traded Bell Aliant Regional Communications Income Fund (Bell Aliant), its 15 per cent stake in CTVglobemedia in addition to its interests in publicly traded companies Clearwire and Sky Terra. Monetizing such investments would further streamline the company's operating structure and remove any "conglomerate discount" that may be influencing its valuation. Further, BCE had recently completed the sale of its satellite services subsidiary, Telesat, from which it was expected to net proceeds of $3.25 billion. Utilizing the proceeds from both the sale of non-core investments in addition to the proceeds from the sale of Telesat would allow a private equity buyer to ultimately reduce the overall purchase price of BCE and, thus, reduce the debt financing and equity investment required.

[24] TELUS press release, June 21, 2007.
[25] Jeffrey Fan, and Phillip Huang, "Upside For Telus Could Be Interesting," UBS Investment Research, June 22, 2007.

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As the wireless market in Canada grew increasingly competitive, it was clear that BCE needed to make additional investments in its network infrastructure. BCE would need to expand its capital spending program, yet faced a slowdown in its operating cash flow due to the erosion of its traditional wireline business. However, privatizing a public company such as BCE would allow the leadership team to undertake improvements to maximize profitability that would otherwise be difficult to achieve under the short-term earnings focus of the public markets.

Further, an LBO structure involved using a high amount of leverage in the capital structure of the acquired company. This created the ability to replace high-cost equity with lower cost debt, thereby lowering the company's cost of capital. This cost of capital "arbitrage" was considered one of the main advantages of the LBO structure and, thus, a privatization.

### DCF Valuation[26]

Determining a value for BCE would allow the potential bidders to assess how much they would be willing to pay to acquire the company, and how much return they could potentially realize. To begin, an initial approximate value would be determined as of the date of BCE's "unaffected" trading price. This date, March 28, 2007, was the date prior to the announcement that KKR was potentially interested in launching a friendly bid for the company. Valuation estimates would then be subsequently revised closer to the bid date to take into account the latest market information.

In constructing a discounted cash flow analysis or DCF (see Exhibit 4 for additional key assumptions) to determine an initial value, the bidders would have to make several assumptions. In terms of the transaction timeline, it would be assumed that the acquisition of BCE would close on December 31, 2007. The company's non-core assets (such as Bell Aliant and CTVglobemedia in addition to its minority investments in Clearwire and SkyTerra) would also be sold as of December 31, 2007. The value of BCE's stake in Bell Aliant would be determined based on the public market value of 100.4 million units trading at \$29.52 per share as of March 28, 2007 less a 10 per cent holding-company discount. Likewise, the value of BCE's investment in Clearwire and SkyTerra would be based on the public market value of 13 million shares trading at \$24.10 per share, and 22.5 million shares trading at \$9.62 per share, respectively, as of March 28, 2007. The value of BCE's 15 per cent stake in CTVglobemedia was estimated to be approximately \$300 million.

As a result of the assumed sale of these non-core assets, BCE's revenue going forward would be driven by its wireline and wireless assets only, which generated \$14,462 million and \$14,541 million in revenue in 2005 and 2006, respectively. It was assumed that the growth rate for revenue for these businesses would be 1.5 per cent, 2.4 per cent, 2.3 per cent, 1.8 per cent, 1.9 per cent and 1.9 per cent, respectively, in each year from 2007 to 2012. EBITDA margins, which had been 36.8 per cent and 36.3 per cent in 2005 and 2006, respectively, were assumed to be 37.5 per cent in 2007 and 38.6 per cent thereon until 2012. Depreciation, which had been 16.4 per cent and 17.1 per cent of revenue in 2005 and 2006, respectively, was assumed be to 17.0 per cent from 2007 to 2012. Due to BCE's significant amount of capital loss carry-forwards, the cash tax rate was estimated to be 15.0 per cent from 2008 to 2010 and 25 per cent from 2011 onwards. Capital expenditures were estimated to be \$2,646 million, \$2,707 million, \$2,755 million \$2,808 million and \$2,862 from 2008 to 2012, respectively. Changes in net working capital were estimated to be four per cent of the net change in revenue. For the purpose of DCF calculations, cash flows were assumed to occur at year-ends (with "time 0" on January 1, 2008, the assumed deal closing date).

[26] Valuation assumptions in this section are the case writer's estimates as based on publicly available equity research reports. Please see Exhibit 5 for further source information.

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In determining the weighted average cost of capital (WACC), it was assumed that the long-term target capital structure for BCE was 40.0 per cent debt and 60.0 per cent equity. The before-tax borrowing cost of the winning consortium was estimated to be approximately 8.0 per cent. The current yield on the 10-year Government of Canada bond was 4.1 per cent. The beta for BCE was assumed to be 0.85. The assumed market risk premium (i.e. the difference between the expected return on stocks versus long-term government bonds) was 5.0 per cent.

In determining the terminal value of cash flows (i.e., the estimated value of the firm at the end of five years, which also represented the present value of future "free cash flows" at the point in time), the bidder had to take into consideration the portion of projected cash flows derived from the wireline versus the wireless businesses. This was an important consideration since each of these businesses had different growth rates and margins. In 2006, wireline accounted for 74 per cent of total revenue. Although there would be an emphasis to increase BCE's exposure to the high growth and high margin wireless business, wireline would remain a significant portion of its cash flow. As such, a conservative estimate of a 1.0 per cent terminal growth rate could be assumed. Total long-term debt attributable to the wireline and wireless business was $9,665 million, minority interest was $1,100, and preferred share would be redeemed at a total cost of $1,694 million. Total shares outstanding as of December 31, 2006, were 807.6 million.

In constructing the IRR analysis for the bidding consortium (see Exhibits 5 and 6), it was assumed a 20 per cent acquisition premium would be offered to the unaffected price and that all options outstanding would be redeemed at a weighted average exercise price of $33 per option. This would amount to an equity value of $29,276 million. Including net debt would bring this amount to an enterprise value of $41,735 million, implying a transaction multiple of 7.5x LTM EBITDA.[27] However, assuming that selected non-core assets were sold in parallel with the acquisition of the company, an adjusted transaction multiple would be considered; that is, a multiple that would be representative of the enterprise value of the business going forward based on its wireless and wireline assets only. This adjusted approach implied a transaction multiple of 6.3x LTM EBITDA.

The proceeds raised from the sale of non-core assets including Telesat, Bell Aliant, CTVglobemedia and minority investments in Clearwire and SkyTerra would be applied to fund the cost of the acquisition. This would leave $34,988 million to be financed through a combination of debt and equity. Based on leverage multiples from previous comparable LBO transactions, it was assumed that the new company could be levered at a total of 5.0x LTM EBITDA based on 3.0x senior debt and 2.0x subordinated debt. Interest rates on each tranche of debt would be 7.0 per cent and 8.0 per cent respectively. This would leave approximately $7,315 million to be financed through equity representing approximately 21 per cent of the remaining proceeds required or 18 per cent of the total purchase price.

The projected free cash flow generated would be applied directly to debt repayment throughout the term of the investment. It would be assumed that a financial buyer would own the company for five years before exiting the investment at a slightly higher multiple of EBITDA than the original investment was made. An exit multiple of 7.0x LTM EBITDA was assumed based on the assumption that a financial owner would undertake operating improvements that would increase EBITDA margins, as well as increase BCE's revenue mix towards the higher growth and higher margin wireless segment.

[27] Last 12 months of earnings before interest, taxes, depreciation, and amortization.

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## Relative Values

As at March 28, 2007, BCE traded at a discount relative to its comparable peers on a P/E (price/earnings ratio) and EV/EBITDA basis (see Exhibit 3). Despite numerous efforts by the BCE leadership team to improve shareholder value, BCE's valuation relative to that of its competitors was likely attributable to its limited exposure to the wireless segment. This segment had been growing at a 16 per cent[28] CAGR rate, yet it comprised only 22 per cent of BCE's consolidated revenues in 2006. This amount was much smaller relative to that of its competitors, for whom wireless comprised 44 per cent and greater than 50 per cent of revenues for Telus and Rogers respectively in 2006.

### Precedent Transactions

Precedent transaction analysis was based on the premise that the value of a company could be estimated by analysing the prices paid to purchase similar businesses. The purpose was similar to comparable company analysis; however, by analysing prior acquisitions, a purchaser could assess how much of a control premium should be paid to acquire the target company. As per Exhibit 7, it appeared that, based on the most recent transactions in the consumer segment, the average transaction multiple ranged between 7.0x to 8.0x on an EV/LTM EBITDA basis.

## CONCLUSION

As the bidding consortiums prepared to assemble their final bids, they had a number of factors to consider. In addition to the required due diligence and valuation, what challenges might arise when financing such a large transaction, given the market environment? What strategic considerations would need to be taken into account relative to the other competing bids? What regulatory requirements would need to be met? What potential opportunities might exist to exit their investment in three to five years? Based on the projected cash flows as outlined, what return could a financial buyer be expected to achieve, and after such analysis, should any bid be made?

Likewise, the Strategic Oversight Committee at BCE faced a number of questions as well. How would they ensure the alignment of interests between management and the new owners of BCE? How would the committee weigh the prospect of an all-cash bid from a financial bidder against a potential cash-and-stock bid from Telus? What price did the committee feel was adequate given BCE's historical and recent share price performance? Ultimately, how would the committee ensure it was maximizing the value to BCE's shareholders?

[28] CRTC Telecommunications Monitoring Report, July 2007.

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**EXHIBIT 1: HISTORICAL TRADING PERFORMANCE**
**(January 5, 2000–March 28, 2007)**

Source: Bloomberg

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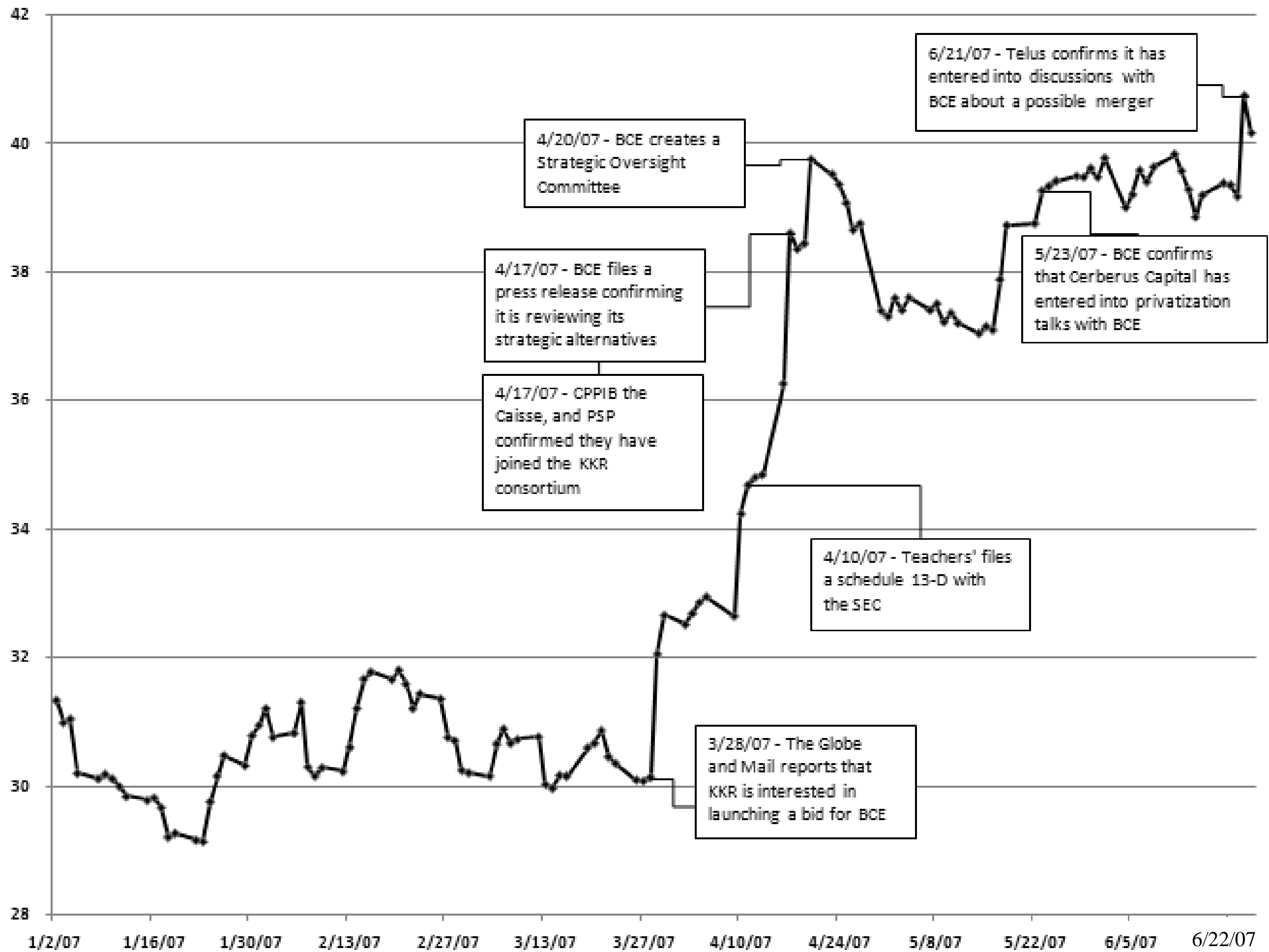
**EXHIBIT 2: BCE INC. STOCK PRICE AND KEY EVENTS**
**(January 1, 2007–June 22, 2007)**




Source: Bloomberg

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## EXHIBIT 3: SUMMARY OF CANADIAN TELECOM COMPARABLES
## (As of March 28, 2007)

**Summary of Canadian Telecom Comparables**
As of 3/28/2007

| Company | Price (C$) | Market Cap (C$ Million) | Enterprise Value (C$ Million) | P/E 2007E | P/E 2008E | EV/EBITDA 2007E | EV/EBITDA 2008E |
|---|---|---|---|---|---|---|---|
| BCE | 30.13 | 24,333 | 37,366 | 14.3x | 14.0x | 5.4x | 5.3x |
| Rogers | 36.96 | 23,917 | 30,104 | 35.2x | 28.0x | 9.2x | 8.4x |
| Telus | 57.67 | 18,963 | 25,011 | 17.2x | 15.3x | 6.6x | 6.1x |
| **Mean** | | | | **22.3x** | **19.1x** | **7.1x** | **6.6x** |
| **Median** | | | | **17.2x** | **15.3x** | **6.6x** | **6.1x** |

Source: Equity Research. Q42006 Canadian Telecom Services Review. Goldman Sachs, February 2007.

## EXHIBIT 4: BCE INC.: SUMMARY OF UNLEVERAGED FREE CASH FLOW

| | 0 | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|---|
| **Year** | **2007E** | **2008E** | **2009E** | **2010E** | **2011E** | **2012E** |
| Total Revenue | 14,759 | 15,119 | 15,471 | 15,744 | 16,046 | 16,356 |
| EBIT | | 3,266 | 3,342 | 3,401 | 3,466 | 3,533 |
| *Tax Rate* | | *15.0%* | *15.0%* | *15.0%* | *25.0%* | *25.0%* |
| Less: Tax | | (490) | (501) | (510) | (867) | (883) |
| After-Tax EBIT | | 2,776 | 2,840 | 2,891 | 2,600 | 2,650 |
| Plus: Depreciation | | 2,570 | 2,630 | 2,676 | 2,728 | 2,781 |
| Less: CAPEX | | (2,646) | (2,707) | (2,755) | (2,808) | (2,862) |
| Change in Working Capital | | (14) | (14) | (11) | (12) | (12) |
| **Total Unleveraged Free Cash Flow** | | **2,686** | **2,749** | **2,801** | **2,507** | **2,556** |

Source: Case writer's estimates based in part on the following equity research reports:

1. Vince Valentini and Eli Papakirykos, TD Newcrest. BCE Inc., "Weak Wireless Adds in Q1 Do Not Change our LBO Valuation," May 3, 2007.
2. Jonathan Allen, RBC Capital Markets. BCE Inc., "LBO Looks Possible." March 29, 2007.
3. Greg MacDonald and Neil Seneviratne, National Bank Financial. BCE Inc., "How Do You Justify a $40 BCE?," April 23, 2007.
4. Glen Campbell and Chris Li, Merrill Lynch. BCE Inc., "BCE buy-out: Fire or Just Smoke?" April 11, 2007.

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## EXHIBIT 5: BCE INC.: KEY LBO ASSUMPTIONS

**BCE Inc.: Key LBO Assumptions**
*Assuming the acquisition takes place on 12/31/07 and exit on 12/31/2012*

| Key Transaction Assumptions | | Source of Funds | |
|---|---|---|---|
| Unaffected Trading Price (03/28/07) | 30.13 | *Proceeds from Asset Sales* | |
| Acquisition premium | 20.0% | Telesat [4] | 3,250 |
| Takeout Price | 36.16 | Market Value of Bell Aliant stake [5] | 2,667 |
| Basic Shares Outstanding (as of 12/31/06) | 807.6 | CTVglobemedia [6] | 300 |
| Plus: BCE Options Outstanding (as of 12/31/06) | 24.2 | Other Assets [7] | 530 |
| Fully Diluted Shares Outstanding | 831.8 | **Total Proceeds from Asset Sales** | **6,747** |
| Less: Option Proceeds [1] | (800.0) | **Portion Remaining to be Financed** | **34,988** |
| **Equity Value** | **29,276** | *Debt* | |
| Add: Net Debt + Preferred Shares + Minority Interest | | Senior Debt @ 3.0x LTM EBITDA | 16,604 |
| Debt (ex: Bell Aliant & Telesat) [2] | 9,665 | Subordinated Debt @ 2.0x LTM EBITDA | 11,069 |
| BCE Preferred Shares [3] | 1,694 | **Total Debt** | **27,673** |
| Minority Interest | 1,100 | *Equity* | 7,315 |
| **Enterprise Value** | **41,735** | **Total Source of Funds** | **41,735** |
| 2007E LTM EBITDA | 5,535 | | |
| EV / LTM EBITDA | *7.5x* | | |
| EV / LTM EBITDA (Adjusted) | *6.3x* | | |

**Notes**
**1** Based on a weighted average exercise price of $33 as of 12/31/06.
**2** Includes long term debt for BCE Inc and Bell Canada divisions only.
**3** Redemption value of preferred shares obtained from the Management Proxy Circular.
**4** Net proceeds obtained from the sale of Telesat.
**5** BCE owns 100.4 millions units of Bell Aliant the market value of which was $29.52 per unit on 3/28/07. Assumes a 10% holding company discount.
**6** CTVglobemedia is a privately held company. Estimates of value are based on equity research consensus estimates.
**7** Includes the stakes held in publicly traded companies Clearwire Corp and SkyTerra.
BCE held 12.9 million shares in Clearwire which closed at $24.10 on 3/28/07 based on an US/CDN exchange rate of US$0.86 on 3/28/07.
BCE held 22.5 million shares in SkyTerra which closed at $9.62 on 3/28/07 based on an US/CDN exchange rate of US$0.86 on 3/28/07.

Source: Case writer's estimates based in part on the following equity research reports:
1. Vince Valentini and Eli Papakirykos, TD Newcrest. BCE Inc., "Weak Wireless Adds in Q1 Do Not Change our LBO Valuation." May 3, 2007.
2. Jonathan Allen, RBC Capital Markets. BCE Inc., "LBO Looks Possible." March 29, 2007.
3. Greg MacDonald, and Neil Seneviratne, National Bank Financial. BCE Inc., "How Do You Justify a $40 BCE?" April 23, 2007.
4. Glen Campbell and Chris Li, Merrill Lynch. BCE Inc., "BCE buy-out: Fire or Just Smoke?," April 11, 2007.

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## EXHIBIT 6: BCE INC.: SUMMARY LBO ASSUMPTIONS

**BCE Inc.**
Projected Income Statement

| | 2005PF | 2006PF | 2007E | 2008E | 2009E | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|---|---|---|
| **Total Revenue** | **14,462** | **14,541** | **14,759** | **15,119** | **15,471** | **15,744** | **16,046** | **16,356** |
| *% Growth* | | *0.5%* | *1.5%* | *2.4%* | *2.3%* | *1.8%* | *1.9%* | *1.9%* |
| Less: Operating Expenses | (9,143) | (9,261) | (9,224) | (9,283) | (9,499) | (9,667) | (9,852) | (10,043) |
| *% of Revenue* | *63.2%* | *63.7%* | *62.5%* | *61.4%* | *61.4%* | *61.4%* | *61.4%* | *61.4%* |
| **Total EBITDA** | **5,319** | **5,280** | **5,535** | **5,836** | **5,972** | **6,077** | **6,194** | **6,314** |
| *% Margin* | *36.8%* | *36.3%* | *37.5%* | *38.6%* | *38.6%* | *38.6%* | *38.6%* | *38.6%* |
| Less: Depreciation | (2,375) | (2,488) | (2,509) | (2,570) | (2,630) | (2,676) | (2,728) | (2,781) |
| *% of Revenue* | *16.4%* | *17.1%* | *17.0%* | *17.0%* | *17.0%* | *17.0%* | *17.0%* | *17.0%* |
| **EBIT** | **2,944** | **2,792** | **3,026** | **3,266** | **3,342** | **3,401** | **3,466** | **3,533** |
| *% Margin* | *20.4%* | *19.2%* | *20.5%* | *21.6%* | *21.6%* | *21.6%* | *21.6%* | *21.6%* |
| Interest Expense | | | | (2,014) | (1,941) | (1,860) | (1,776) | (1,690) |
| EBT | | | | 1,252 | 1,401 | 1,541 | 1,690 | 1,843 |
| Less: Tax | | | | (188) | (210) | (231) | (422) | (461) |
| *% Effective Cash Tax Rate* | | | | *15.0%* | *15.0%* | *15.0%* | *25.0%* | *25.0%* |
| **Net Income** | | | | **1,064** | **1,190** | **1,310** | **1,267** | **1,382** |

**BCE Inc.**
Summary of Free Cash Flow Available for Debt Repayment

| | 2007E | 2008E | 2009E | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|---|
| Net Income | | 1,064 | 1,190 | 1,310 | 1,267 | 1,382 |
| Plus: Depreciation | | 2,570 | 2,630 | 2,676 | 2,728 | 2,781 |
| Less: Capex | | (2,646) | (2,707) | (2,755) | (2,808) | (2,862) |
| *% of Revenue* | | *17.5%* | *17.5%* | *17.5%* | *17.5%* | *17.5%* |
| Changes in NWC | | (14) | (14) | (11) | (12) | (12) |
| *% of Change in Sales* | | *4.0%* | *4.0%* | *4.0%* | *4.0%* | *4.0%* |
| **Free Cash Flow Available for Debt Repayment** | | **974** | **1,099** | **1,220** | **1,175** | **1,288** |
| *Cumulative Free Cash Flow* | | *974* | *2,073* | *3,293* | *4,468* | *5,756* |

**BCE Inc.**

| Summary Debt Schedule | 2007E | 2008E | 2009E | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|---|
| **Senior Debt - Interest Calculation @ 7%** | | | | | | |
| Beginning Balance | | 16,604 | 15,630 | 14,531 | 13,311 | 12,136 |
| Less: Debt Repayment | | (974) | (1,099) | (1,220) | (1,175) | (1,288) |
| Ending Balance | 16,604 | 15,630 | 14,531 | 13,311 | 12,136 | 10,848 |
| Interest Expense | | 1,128 | 1,056 | 974 | 891 | 804 |
| **Subordinated Debt - Interest Calculation @ 8%** | | | | | | |
| Beginning Balance | | 11,069 | 11,069 | 11,069 | 11,069 | 11,069 |
| Less: Debt Repayment | | - | - | - | - | - |
| Ending Balance | 11,069 | 11,069 | 11,069 | 11,069 | 11,069 | 11,069 |
| Interest Expense | | 886 | 886 | 886 | 886 | 886 |
| **Total Debt** | 27,673 | 26,699 | 25,600 | 24,380 | 23,205 | 21,917 |
| *% Repaid* | | *3.5%* | *7.5%* | *11.9%* | *16.1%* | *20.8%* |

**BCE Inc.**

| Exit Value Calculations | FYE December 31st | | | | | |
|---|---|---|---|---|---|---|
| | 2007E | 2008E | 2009E | 2010E | 2011E | 2012E |
| Sponsor Year | 0 | 1 | 2 | 3 | 4 | 5 |
| EBITDA Exit Multiple | | 7.0x | 7.0x | 7.0x | 7.0x | 7.0x |
| LTM EBITDA | | 5,836 | 5,972 | 6,077 | 6,194 | 6,314 |
| Enterprise Value (@ 7.0x LTM EBITDA) | | 40,852 | 41,803 | 42,540 | 43,357 | 44,195 |
| Less: Net Debt | | (26,699) | (25,600) | (24,380) | (23,205) | (21,917) |
| Equity Value | | 14,153 | 16,203 | 18,159 | 20,152 | 22,278 |
| Net Cash Flow (5-Year Exit) | (7,315) | - | - | - | - | 22,278 |

Source: Case writers' estimates based in part on the following equity research reports:

1. Vince Valentini and Eli Papakirykos TD Newcrest. BCE Inc., "Weak Wireless Adds in Q1 Do Not Change our LBO Valuation." May 3, 2007.
2. Jonathan Allen, RBC Capital Markets. BCE Inc., "LBO Looks Possible." March 29, 2007.
3. Greg MacDonald and Neil Seneviratne National Bank Financial. BCE Inc., "How Do You Justify a $40 BCE?" April 23, 2007.
4. Glen Campbell and Chris Li, Merrill Lynch. BCE Inc., "BCE buy-out: Fire or Just Smoke?" April 11, 2007.

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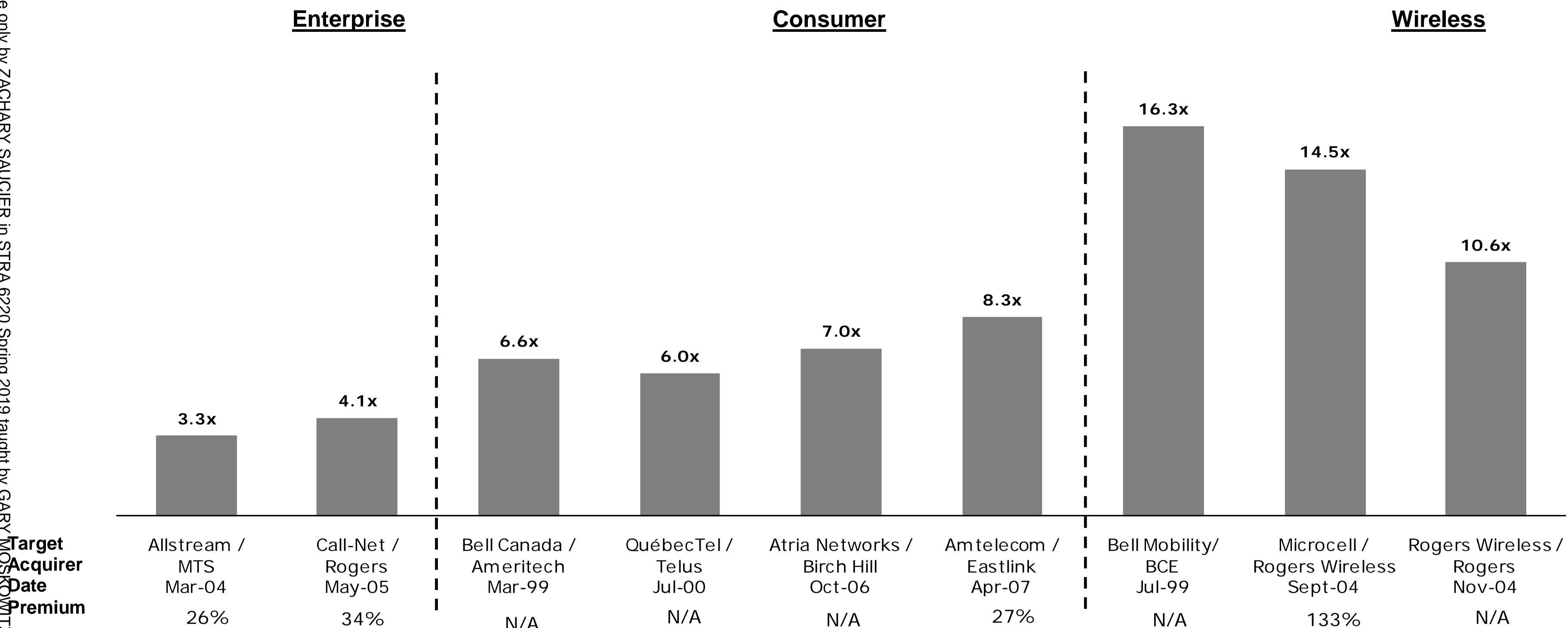
## EXHIBIT 7: SELECTED TELECOM PRECEDENT TRANSACTIONS (EV / LTM EBITDA)[1]




Source: CIBC internal document—used with permission.

[1] Enterprise Value / Last 12 Months Earnings Before Interest Tax Depreciation and Amortization.

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