



Telus offers to buy Microcell

COMMENT – May 14, 2004

Telus made an offer to acquire Microcell on May 13, 2004. The offer is valued at \$1.1 billion (equity value). Microcell has 1.3 million subscribers (wholesale and retail), which makes Telus' bid worth \$849 per subscriber or about \$60 per covered head of population. The Telus offer was made at \$29 per share, although right away the Microcell share price rose to over \$31 indicating investors likely feel a bidding war will now be underway.

Why does Telus want to buy Microcell?

There is little operational synergy between Telus and Microcell. The networks are incompatible, so Telus is faced with maintaining yet another network – it already has one for PCS and another for MiKE – or disposing of Microcell's. Telus already has much better geographic coverage than Microcell because of its enhanced resale and roaming agreement with Bell Canada.

Adding Microcell's spectrum is of little use. Telus is up against Industry Canada's spectrum cap – it could not add the 30 MHz held by Microcell without exceeding the cap. Industry Canada is reviewing the spectrum cap, but no decision has been rendered.

The primary result of Telus buying Microcell would be to eliminate a pesky competitor – Microcell's CityFido service has been chipping away at Telus' base in Vancouver and Microcell has been threatening to roll it out elsewhere.

The deal would add to Telus whatever portion of Microcell's subscriber base that would switch. Telus has been trying hard to market to this group – the younger “urban” crowd. But since Microcell's subscribers generally do not have long term contracts migrating them over is far from a sure thing and could be very expensive in terms of handsets and network equipment – likely 100's of millions of dollars. And during any migration, Rogers and Bell would surely target Microcell's subscriber base, further upping the ante.

Timing may have been influenced by the evolution of the foreign ownership debate

With recent discussion surrounding the possible lifting of foreign ownership restrictions, the timing of the Telus bid could serve to stave off near-term immediate plans for major new players coming in from abroad. A foreigner wanting to trump Telus at this point in time needs a domestic partner that would be the majority owner. And with no new spectrum on the market until a possible 3G auction in 2006, restrictions or not, there are few other opportunities to buy into the Canadian market.



And another motivation – Mobile is king

Mobile is rapidly becoming the largest single market segment in the telecom industry. LYA estimates that in 2004 Mobile will be 50% bigger than the Long Distance business and will have the industry's highest growth rate.

Maybe the real motivation is that Telus knows this too. Telus has spent a great deal of effort becoming the new-age telco – migrating its business from being a “local and long distance” company to being a thoroughly modern “mobile and broadband” operator.

BCE's place

The big loser is BCE. After being taken by surprise by the MTS-Allstream deal – which via its 22% stake in MTS is becoming an unwitting part-owner of its biggest wireline competitor – it is again struck in its heartland. Microcell's subscriber base and network investment is centered in Bell Canada's most lucrative markets – Toronto, Ottawa, Montreal.

So, if there is to be a bidding war, who else is there to bid?

MTS has just spent its cash buying Allstream for \$1.6 billion. Rogers Wireless already with \$2 billion in debt is faced with possibly repurchasing the 48.6 million shares held by AT&T Wireless for \$1.6 billion. Other original investors in Microcell – Call-Net (Sprint Canada), Shaw Communications and Videotron (Quebecor) – could be interested but they are still recovering from the burst telecom bubble.

As LYA demonstrated last year *, however, there is ample room for four mobile carriers in Canada. With 17 million Canadians yet to own a mobile phone, the story is far from over.

* LYA Report “The Case for Four Mobile Telecom Operators in Canada”, May 9, 2003.

*The views expressed herein are solely those of Lemay-Yates Associates Inc.
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