

BCE's \$52-billion buyout at risk

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The \$52-billion takeover deal for BCE Inc., Canada's biggest telecommunications company, is in jeopardy after an independent adviser said Wednesday that volatile market conditions and the mountain of debt involved in financing the country's largest-ever corporate buyout would put the company's solvency at risk.



BCE shares - among the most widely held in Canada - plunged 40 per cent after the announcement, which could mark the end of a private-equity group's 18-month pursuit of the Canadian icon.

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Shares in BCE dropped 40 per cent to less than \$23 shortly after trading began on Wednesday. They recovered slightly to close down \$13.10, or 34.16 per cent, at \$25.25.

Montreal-based BCE, parent company of Bell Canada, said it is still working with the adviser, KPMG. However, if KPMG is unable to deliver a favourable opinion on the deal by the Dec. 11 closing date, "the transaction is unlikely to proceed," BCE said.

"We are disappointed with KPMG's preliminary view of post-transaction solvency, which is based on numerous assumptions and methodologies that we are currently reviewing," Siim Vanaselja, BCE's chief financial officer said in a statement. "The company disagrees that the addition of the LBO (leveraged buyout) debt would result in BCE not meeting the technical solvency definition."

In order to remain solvent, the value of BCE's cash and assets must exceed liabilities.

"I think the highest probability outcome is that the deal is dead," Barry Allan, a founding partner of Marret Asset Management in Toronto, told Reuters.

But there's still a chance the deal could be salvaged if it were repriced from its current terms of \$42.75 a share, possibly at \$35, Allen said.

The buyout is being led by the Ontario Teachers' Pension Plan and U.S. private equity firm Providence Equity Partners. In a separate statement, the consortium said it was committed to

following through with the deal but strictly on the terms originally struck, which require BCE's solvency.

"The purchaser has been working closely with BCE to take the actions required by the definitive agreement," the statement said, adding the parties "will continue to fulfil (the) obligations under the terms of the agreement."

The deal would saddle BCE's new owners with about \$35 billion in additional debt.

"Unless the private-equity consortium pumps in more equity, they will be hard-pressed to make it solvent," said **Neeraj Monga**, an analyst at **Veritas Investment Research**. "You've seen valuations compress across the board, equity risk premiums are high, and I think those are the things that are going to impact it."

After the announcement, Dominion Bond Rating Service placed its ratings of BCE Acquisition Inc., BCE Inc. and Bell Canada under review.

"Based on preliminary indications it is unlikely that a condition - specifically, a positive solvency opinion - that was required upon closing the privatization of BCE on Dec. 11, 2008, will be met," the Canadian credit rating agency said.

DBRS said if the privatization does not go ahead, it expects to change the ratings of BCE and Bell Canada to a "strong investment-grade level."

Troy Crandall, telecom analyst at the investment firm MacDougall, MacDougall & MacTier, said a failure of this deal to go through would not be a complete disaster for BCE. If the company remains publicly traded, it is already more efficient and productive than it was before it was courted by private equity, he said.

"It has a fresh marketing team, fewer managers, and that's starting to show up already in its financial statements," he said.

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On Monday, BCE shares jumped nearly 10 per cent after the U.S. government agreed to help bail out Citigroup Inc. It is the biggest lender behind the deal, responsible for \$13 billion US in loans. Toronto-Dominion Bank, Royal Bank of Scotland and Deutsche Bank are the others. Royal Bank

of Scotland was bailed out with a 20-billion-pound (\$37.69-billion) lifeline from British authorities in mid-October.

BCE chief executive George Cope said in the statement that the company had \$2.8 billion in cash on hand, a low level of midterm debt maturities, "and continues to deliver solid operating results."

Pension obligations may be one area KPMG is hesitant about. A recent note from Canaccord Adams analysts said the company held a \$849-million pension deficit before this year's steep declines in financial markets. By the analysts' estimate, the deficit has grown to between \$3 billion and \$4 billion as losses mount in its portfolio.

"The potential impact of the recent decline in the company's pension plan assets could increase deal risk," the analysts said.

UBS analyst Jeffery Fan said in a note on Wednesday pensions are one theory behind the inability to meet the solvency test, "however, it appears that this may not have been the only issue." He also noted the waiver of the Dec. 11 deadline would require the lenders and equity sponsors to agree.

Fan added that while a fundamental value of the company's shares is in the \$24-to-\$25 range, "it will likely overshoot on the downside."

The takeover deal, which would take the company private, was announced in June 2007. Since then, it has faced regulatory scrutiny as well as a Supreme Court of Canada challenge, following a ruling by the Quebec Court of Appeal that almost stopped the deal on claims that BCE had not considered the rights of bond-holders.

In June of this year, the Supreme Court ruled in favour of BCE.

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