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Canadian Wireless 2007-2014: Assessing the Impact of New Entrants

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Commentary

Canadian Wireless 2007-2014: Assessing The Impact of New Entrants (September 2009, 104 pages) contains detailed analysis by company, market, region, **please see Table of Contents for what is included in this Report.** Sources include Convergence analysis, estimates & company interviews, annual/quarterly reports & presentations, CRTC, Industry & Statistics Canada.

We forecast a 3% decline in Canadian wireless service ARPU for 2009, with data accounting for 20% of wireless service revenue and all of 2009 service revenue growth. Over the last year Canadian wireless voice revenue growth has moved into negative territory, whereas data growth continues to be robust. Growing adoption of smartphones/data devices, which we estimate will reach 23% by year-end 2009 (and break 50% in 2014), is helping to drive data revenue growth.

Based on what we project new entrants pricing will be and the experience and metrics of the 4 major US wireless providers over the last three years, we are forecasting Canadian data growth will not be sufficient enough to maintain overall incumbent ARPU growth going forward.

In the US, data is 30% of service revenue (and effectively all 2009 service revenue growth), approximately double three years ago. The US is at least two years ahead of Canada in terms of data revenue as a percentage of total service revenue.

In the US, Leap, MetroPCS and Sprint's Boost Mobile have ushered in an era of low-priced unlimited voice, text and data packages. AT&T, Sprint, T-Mobile, Verizon have countered though are still on comparable package prices on average 35%-50% higher than the discount players. The net result for the four major carriers has been no ARPU growth over the last 3 years. Negative economic conditions have also played a significant role, but competition has been just as critical if not more.

In Canada we are also expecting a pricing differential between new entrants & incumbents/flanker brands. Without aggressive pricing new entrants, especially non-cable, will have a difficult time gaining traction. We expect both new entrant cable and independents will introduce MetroPCS-style pricing and packaging.

Based on our detailed subscriber models **(broken out in the Report by player & region)** we forecast new entrants' will have 7.8 million or 24% of Canadian wireless subscribers by year-end 2014. We forecast Canadian subscriber additions will average 1.9 million/annum 2010-2014 as opposed to 1.5 million 2005-2009, mainly due to lower prices (based on what the consumer receives for the price), and wireless penetration at 92.5% year-end 2014, up from 68% year-end 2009.

Wireless substitution will also accelerate due to more competitive wireless pricing, negatively impacting cable & telco wireline. We forecast wireless-only households will reach 23% of Canadian households year-end 2014, up from 8% at present. We forecast 55% of the incumbents' residential telephone wireline loss in 2011 will come from wireless substitution, up from 21% in 2008.

Our models demonstrate (excluding spectrum expenditure):

Videotron, Shaw and EastLink will be EBITDA positive before the end of their second year of operations, and that DAVE, Globalive and Public Mobile will be EBITDA positive in their third year of operations.

New entrant cablecos will have positive free cash flow in the third year of operations, whereas DAVE, Globalive and Public Mobile will be positive in their fourth year.

Positive cumulative pre-tax free cash flow for Videotron in year five, and EastLink and Shaw in year six; whereas we forecast DAVE, Globalive and Public Mobile, will need at least 9-10 years to realize positive cumulative pre-tax free cash flow.

If the new entrant independents do not price competitively enough they will not gain a significant number of subscribers. This issue, combined with the high capital burn rate (for spectrum & network), makes being acquired (incumbents can not acquire new entrants until 2014) highly relevant. Hence the strategy of doing as much market share damage as possible in contrast to the current 'rationality' of the Canadian wireless market place is one to keenly observe going forward.

By year-end 2009, new entrants to the Canadian local residential wireline telephone market, predominantly cable players, will have 30% of the market, up from 3% at year-end 2004. Success has come from the ability to leverage customer base (especially those customers that take TV and/or Internet), competitive pricing especially in a bundle (and convenience of one provider) and no trade-off in the quality of telephone service provided.

New cable wireless entrants will we forecast render a repeat performance based on the same three components. Despite not having the same components, non-cable wireless new entrants will also realize strong penetration rates, though not as formidable on a per capita/coverage basis as cable.

By the end of 2014, Quebec, followed by Alberta/BC, and Ontario, will see the most market impact from new entrants. **The Report includes detailed forecasts by player & region.** Despite the impact of new entrants, we forecast by 2014 Rogers will still be Canada's largest player, followed by Bell and Telus.

Over the 2010-2014 timeframe, we forecast Bell, Rogers & Telus will gain more consumer wireless subscribers in their traditional residential wireline telephone and cable footprint regions than out-of-region. We believe the wireless market will increasingly regionalize and that in-region bundles, will become even more important. By year-end 2009, 65% of residential Canadian cable & telco customers will have two or more services with the same cable or telco, up from 61% year-end 2008.

Out-of-region (i.e. outside the incumbents traditional residential telephone footprint and in Rogers case cable footprint), without competitive multi-product consumer offers (or deep price cuts which we do not anticipate), incumbents and their flanker brands will find it difficult to compete with the bundled consumer pricing and overlap of a new cable entrant or the regional incumbent carrier who will be fighting to preserve growth, as well as the competitive pricing of the non-cable new entrants.

The incumbent flanker brands are in many cases up to 30% less than incumbent offers, hence the incumbents have already set in price cuts. We do expect the incumbents to hit back with lower-priced all in packages as the major US wireless providers have done. However, we do not expect drastic moves (would be a death knell for ARPU, EBITDA, stock price, etc) by the incumbents especially out of region, given their lack of competitive advantage, but we do expect in-region to see bundle discounts and retention offers improve.

Rogers has the most potential exposure, with approximately 60% of its consumer wireless subscribers out-of-region (where it does not offer cable services) primarily in Alberta, BC & Quebec, followed by Telus with approximately 51% of its consumer wireless subscribers out-of-region (where it does not offer residential wireline telephone), primarily in Ontario & Quebec. Bell is the least exposed of the big three incumbents as just approximately 13% of its consumer wireless subscribers are out-of-region (where it does not offer residential wireline telephone) primarily in Alberta & BC.