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AMERICAS MERGER REPORT

Dec 13, 2022 – 12.00pm ET

Shaw Communications (SJR/B CN)/ Rogers Communications (RCI/B CN)

Update

We believe that Shaw and Rogers have the upper hand in the Tribunal process.

Deal Terms

1 SJR/B CN = C$40.50

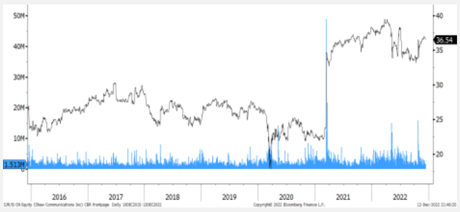
Target: Shaw Communications

Country	Canada
Bloomberg	SJR/B CN
Sector	Telecommunications
Share price (CAD)	36.515
Market cap (CAD mn)	18,252.4
Free float %	~93

Acquirer: Rogers Communications

Country	Canada
Bloomberg	RCI/B N
Sector	Telecommunications
Share price (CAD)	60.76
Market cap (CADm)	30,728.7
Free float %	~90

Shaw Price Chart



Deal status: Case pending at Tribunal

Key concerns of the commission

- The key theory of harm is the separation of Freedom from Shaw's wireline assets that provide backhaul and enable bundling of the two services.
- Shaw Mobile will move to Rogers, which will eliminate a disruptive bundle product and lead to price increases
- Freedom would be a weakened competitor under Videotron's ownership because Rogers is set to acquire a number of assets, including infrastructure and personnel, that currently support the wireless carrier.
    - The relationship between Videotron and Rogers will be governed by a complex web of agreements, covering matters from transitional services to spectrum swaps.
    - The decades-long agreements are likely to make Videotron more aligned with Rogers than Shaw ever has been. And they make Videotron vulnerable to anti-competitive actions by Rogers.

Merging parties' arguments:

- Owning wireline infrastructure is not a prerequisite of success in wireless
    - More than 70% of Freedom's subscriber base has developed in Ontario where Shaw has essentially no wireline infrastructure
    - All major wireless carriers in Canada operate successfully in geographies where they do not own residential wireline. Bell and Rogers in British Columbia and in Alberta, Telus and Rogers in Quebec, Telus and Freedom in Ontario.
- Backhaul arrangements between the two companies are industry standard.
    - The Montreal-based company has struck a deal that would allow it to access the combined Rogers-Shaw entity's cable network in Western Canada at what the companies have described as "favourable rates."
    - Those rates are below the mandated wholesale rates set by the Canadian Radio-television and Telecommunications Commission.
    - The commercial arrangements that Videotron has struck with Rogers for access to cable infrastructure in Western Canada are non-binding, Quebecor has the option to turn to alternative providers
- Videotron will be a more viable competitor than Shaw:
    - Freedom has an immediate path to offering 5G services as compared to Shaw
    - Shaw does not have the resources (and might lack the willingness) to make the necessary investments to remain competitive.

CBR View:

- Based on the above, we believe that the merging parties' position is strong, their arguments with regards to wireless and wireline separation appear to be convincing.
- Rogers / Shaw will provide certain services to Videotron, however we understand that pricing will be lower than mandated wholesale rates and Videotron will have alternative providers to switch to if it elects to do so.
- The fact that Rogers was reluctant to divest Freedom to Videotron and their past debates around network sharing might signal that the divestiture buyer will be a strong number 4 and will pose competitive threat to the top 3 including Rogers
- The loss of Shaw Mobile might be an issue, however we note that
    - the product represents only 5% of Shaw revenues
    - Rogers and Videotron might also offer bundles in the affected service areas which might reduce the harm
    - the parties might use the efficiencies defense to counter remaining negative effects in this regard.

Timing

- Rogers and Shaw have extended the outside date under their Arrangement Agreement until December 31, 2022.
- That date can be further extended to January 31, 2023 at the option of either Rogers or Shaw, provided that Rogers continues to have in place committed financing available to complete the merger.
- Neither Rogers nor Shaw is obligated to extend the outside date beyond January 31, 2023.
- Federal Court Chief Justice Paul Crampton, who is overseeing the hearings, said he would like to release a decision before Christmas if possible.
- The tribunal's decision could be appealed to the Federal Court of Appeal by either side. If the Competition Bureau loses, it could seek a stay that would prevent the merger from closing until the appeal can be heard

Valuation

- We estimate a standalone value of around CAD28-29/Shaw share based on peer multiples and industry index performance since the deal announcement.

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Timing

- **Outside date**
    - Rogers and Shaw have extended the outside date under their Arrangement Agreement until December 31, 2022.
    - That date can be further extended to January 31, 2023 at the option of either Rogers or Shaw, provided that Rogers continues to have in place committed financing available to complete the merger.
    - Neither Rogers nor Shaw is obligated to extend the outside date beyond January 31, 2023.
- **Debt financing**
    - On August 31, 2022, Rogers announced that it had obtained the consents required to extend its financing for closing of the transaction to December 31, 2023.
    - Extending that financing past December 31, 2022 requires that Rogers pay its lenders a further fee of approximately CAD $264 million.
- **Tribunal process**
    - Oral arguments are heard on December 13 and 14.
    - Five weeks have been set aside for the parties to present their evidence and arguments. After that, the tribunal members assigned to the case will deliberate and then issue a decision on whether it finds that there is indeed a competitive issue and if so, what remedy is required.
        - Federal Court Chief Justice Paul Crampton, who is overseeing the hearings, said he would like to release a decision before Christmas if possible.
    - The tribunal's decision could be appealed to the Federal Court of Appeal by either side. If the Competition Bureau loses, it could seek a stay that would prevent the merger from closing until the appeal can be heard.

Key regulatory concerns

- Closing arguments of the commissioner:

    - **The key theory of harm is the separation of Freedom from Shaw's wireline assets that provide backhaul and enable bundling of the two services**.
        - The commissioner argues that in Quebec, 90% of Videotron's wireless customers in Quebec are also wireline customers.
        - Wholesale access to a wireline network replaces significant fixed costs with significant variable costs, which lowers the incremental margin on wireline.
    - **Shaw Mobile** will move to Rogers, which will **eliminate a disruptive bundle product** and lead to price increases.
        - Rogers would acquire 450,000 Shaw Mobile customers in Western Canada, who receive steeply discounted wireless services that are sold in bundles with cable and internet services.
        - Shaw Mobile was launched by Shaw as a wireline customer retention tool in the face of intense competition from Telus in consumer wireline services.
        - The watchdog has argued that the Shaw Mobile brand was a disruptive competitor that was responsible for much of the telecom's recent wireless subscriber growth
    - **Freedom would be a weakened competitor under Videotron's ownership because Rogers is set to acquire a number of assets, including infrastructure and personnel, that currently support the wireless carrier.**
    - **The relationship between Videotron and Rogers will be governed by a complex web of agreements**, covering matters from transitional services to spectrum swaps.
        - The decades-long agreements would make Rogers both a supplier and competitor to Vidéotron, with too much sway over the Montreal-based company's business.
        - These agreements are likely to make Videotron more aligned with Rogers than Shaw ever has been. And they make Videotron vulnerable to anti-competitive actions by Rogers.
        - Rogers Quebecor had issues with their earlier network sharing agreement in the past.
            - Last year, Videotron filed a lawsuit against Rogers seeking $850-million in damages over a joint network operating agreement in Quebec and the Ottawa area.
            - Videotron will be exposed to the goodwill of a competitor – Rogers - it has already accused of "sabotaging" its Quebec network sharing agreement
                - The Proposed Divestiture of Freedom will put Videotron in a position of dependence and enable Rogers to protect its consumer wireless and wireline businesses from competition by raising Videotron's cost (of wireline backhaul services)
                - If Videotron manages to compete more aggressively in Western Canada than would be desired by Rogers, Bell or Telus, there could be potential for anti-competitive retaliation in Videotron's home market, Quebec, where it has the strongest presence and has its wireline assets.

        - The existence of these long-term contracts and the ability of Rogers to discipline Videotron also likely serve to heighten coordination risk
- **Shaw's 5G roll-out and 3500 MHz purchase were shelved as a direct result of the announcement of the Rogers deal**.
    - **CBR comment:**
        - This might be true, however there is not much one can do about a past spectrum auction.
- **The merger lessens network competition and network choice**

■ Merging parties' closing arguments:

- **Videotron will be a more viable competitor than Shaw:**
    - Freedom has an immediate path to offering 5G services as compared to Shaw
        - Quebecor believes it could launch 5G wireless services outside of Quebec within three months of acquiring Freedom
            - Vidéotron had paid hundreds of millions of dollars for wireless spectrum in 2021 to expand across the country from its base in Quebec.
        - Shaw's and Freedom's wireless offerings will become less competitive if the Transaction is blocked. 5G services are now available from the Big 3 to approximately 70% of the Canadian population, including in all of Ontario, Alberta and British Columbia. Freedom is thus "an outlier in not having 5G capability.
    - Parties claim that Shaw does not have the resources to make the necessary investments to remain competitive
        - Shaw is concerned about future capital required to compete more effectively both on the wireline and wireless side of the business longer term.
        - Shaw has been steadily losing market share to Telus in its core internet and television business over the past decade.
        - The company's dividend growth has been stagnant, which is important as a public company, especially in the telecom industry, and Shaw shares underperformed peers over recent years.
            - "We have not been able to increase our dividend since 2016 when we made the investment into Wind"
    - CBR Comment:
        - **Videotron has shown that it is willing to invest to compete, while Shaw's controlling shareholders' willingness to make the significant capex investment required might be questionable.**
        - **We believe that the fact that Rogers was reluctant to divest Freedom to Videotron and their past debates around network sharing might signal that the divestiture buyer will be a strong number 4 and will pose competitive threat to the top 3 including Rogers.**
        - Quebecor and its Vidéotron subsidiary were initially left out of talks with Rogers and Shaw.
            - Some observers suggested a lawsuit between Quebecor and Rogers stemming from a fraught arrangement to jointly build a cellular network in Quebec and the National Capital Region was to blame for the initial shunning of Quebecor, while others said Rogers was interested in selling some of the wireless operations to a less-aggressive competitor.
- **Bundling**
    - **Owning wireline infrastructure is not a prerequisite of success in wireless**
        - **More than 70% of Freedom's subscriber base has developed in Ontario where Shaw has essentially no wireline infrastructure**.
            - **The Commissioner has also conceded there is no significant lessening of competition (SLC) in Ontario**.
            - Freedom's experience in Ontario shows that its wireless business model succeeded independently of wireline ownership. It is impossible to reconcile the concession that no SLC arises in Ontario (where Shaw has no wireline network in Freedom's wireless footprint) with the allegation of an SLC in British Columbia and Alberta where Freedom has a smaller market share.
                - "The fact that Freedom has almost double the market share in ON than in AB and BC is a strong indication that wireless carriers (and Freedom in particular) can succeed without wireless-wireline integration."
        - **All major wireless carriers in Canada operate successfully in geographies where they do not own residential wireline**. Bell and Rogers in British Columbia and in Alberta, Telus and Rogers in Quebec, Telus and Freedom in Ontario.

        - Videotron has a long history of successful competitive disruption in Quebec. It began offering wireless services in 2006 as an MVNO on the Rogers network.
        - Videotron plans to offer prices lower than currently offered by competitors. It has committed to the Minister that it will price wireless plans no higher than it does in Quebec.
    - **Today there are two providers of bundled services in British Columbia and Alberta: Telus and Shaw. After the Transaction, there will be three**—Telus, Rogers, and Videotron enabled by a favourable TPIA agreement, all with 5G capability. The Transaction will boost competition between bundled products, not reduce it.
    - We note that Globalive, a competing bidder for Freedom Mobile, has criticized the sale to Videotron arguing it is not a pureplay wireless player.
        - "Videotron is not an adequate remedy to the anti-competitive consequences of this proposed merger because it is not a true, independent pureplay operator - and pureplay is what Canada is sorely lacking. The best-known example of the impact of pureplay is T-Mobile in the US, which successfully disrupted the market, returning $130 billion in savings to US subscribers since their entrance in the market."
- **Synergies / efficiencies vs harms**
    - The Commissioner's own expert predicts that Freedom's prices will go down by 15-17% in British Columbia and Alberta as a result of the transaction
    - The same econometric model suggests that overall, on all wireless brands taken collectively (excluding, as he suggests is more appropriate,39 pre-paid only brands), wireless prices will be unaffected in Ontario, and will "increase on average by 0.8 percent in Alberta and by 2.5 percent in British Columbia.
    - Rogers signalled back in March, 2021, that it expects the merger to result in $1-billion of synergies over three years.
        - The deal will allow the companies to upgrade networks in Western Canada and offer better prices and service.
    - **CBR Comment:**
        - **the merging parties might use the efficiencies defense to counter any harms resulting from the combination.**
        - **Canada has a so-called efficiencies defence for mergers that let companies undertake mergers that will harm competition if a union creates efficiencies that are "greater than and offset" the harm the merger causes to competition.**
- **Shaw mobile**
    - Shaw's wireless business in Alberta and British Columbia generated approximately **only 5% of Shaw's revenues** in fiscal 2021.
    - The low prices that Shaw Mobile customers were paying for their wireless services were "heavily subsidized" by high internet costs.
    - From the beginning, the strategy regarding Shaw Mobile was to shift from launch-driven growth to profitability, given that the introductory promotional pricing was not sustainable in the long term. Shaw Mobile's continued growth is both time limited and unlikely to persist in its current form.
    - If Rogers fails to replicate any "disruptive" force that Shaw Mobile played, it risks losing its most valuable wireline subscribers.
    - Post-closing, Rogers will face even greater competitive pressures in British Columbia and Alberta than those that led Shaw to introduce Shaw Mobile. The entry of Videotron's bundled products, at lower prices, will challenge Rogers more than Shaw is currently challenged.
        - Videotron will use TPIA to offer wireline services at competitive prices in the West and Ontario.
- **Backhaul agreement with Rogers**
    - Backhaul arrangements between the two companies are industry standard.
    - The Montreal-based company has struck a deal that would allow it to access the combined Rogers-Shaw entity's cable network in Western Canada at what the companies have described as "favourable rates."
        - **Those rates are below the mandated wholesale rates** set by the Canadian Radio-television and Telecommunications Commission.
        - **Currently, in British Columbia and Alberta, Freedom accesses wireline backhaul from Shaw at market rates.** It also accesses additional backhaul from third parties in British Columbia and Alberta, again at market rates, as it does in Ontario (where Shaw is not present).
    - **Network access services are entirely at Videotron's option.**
        - The commercial arrangements that Videotron has struck with Rogers for access to cable infrastructure in Western Canada are non-binding, **Quebecor has the option to turn to alternative providers**

- “We get the entirety of Freedom and we get attractive arrangements that we can take advantage of if we so choose, or disregard, if it is in the company’s interest to do that.”
- Freedom Mobile operates predominantly in urban areas where **multiple third parties compete to provide backhaul services.** Every route that serves Freedom Mobile’s network is forborne from regulation, which means that the CRTC has determined that there is sufficient competition for the provision of backhaul services on these routes.
- CRTC decided to forbear from regulating backhaul given the healthy, competitive market. Yet the Commissioner asks the Tribunal to second-guess this policy choice and to find that backhaul leases will weaken Freedom and damage competition in the wireless market.
- Videotron will use TPIA to offer wireline services at competitive prices in the West and Ontario.

CBR summary

- **Based on the above, we believe that the merging parties’ position is strong, their arguments with regards to wireless and wireline separation appear to be convincing.**
- **Rogers / Shaw will provide certain services to Videotron, however we understand that pricing will be lower than mandated wholesale rates and Videotron will have alternative providers to switch to if it elects to do so.**
- **The loss of Shaw Mobile might be an issue, however we note that**
  - **the product represents only 5% of Shaw revenues**
  - **Rogers and Videotron might also offer bundles in the affected service areas which might reduce the harm**
  - **the merging parties might use the efficiencies defense to counter remaining negative effects in this regard.**

Valuation

- We estimate a standalone value of around CAD28.50/Shaw share based on peer multiples and industry index performance since the deal announcement.
- **Peers**
  - We estimate a fair value of around CAD30/Shaw share based on peer multiples not accounting for a possible break fee.
  - We applied a discount to market leaders’ multiples due to Shaw’s scale issues and competitive challenges (no 5G spectrum, capex needs).

Company	Ticker	EV	FY1 EV/EBITDA	FY2 EV/EBITDA
Shaw	**SJR/B CN**	**$23,722**	**9.4x**	**9.3x**
Rogers	RCI/B CN	$67,401	10.5x	9.2x
Telus	T CN	$65,051	9.8x	8.9x
Quebecor	QBR/B CN	$13,649	7.0x	6.8x
BCE	BCE CN	$92,917	9.0x	8.7x
PEER AVERAGE			**9.1x**	**8.4x**

- **Index performance**
  - The Solactive Canada Telecom PR index is up 13% since the deal announcement.
  - Based on the cca CAD24 undisturbed share price, a similar performance would imply a share price of CAD27/Shaw share (or somewhat lower due to the above mentioned headwinds).

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