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Conference Call Transcript

RCI - Q3 2009 Rogers Communications Inc. Earnings Conference Call

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PRESENTATION

Operator



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Good morning ladies and gentlemen. Welcome to the Rogers Communications third quarter earnings conference call.

(Operator Instructions)

And I would now like to turn the conference over to Mr. Bruce Mann of the Rogers management team. Please go ahead.

Bruce Mann - Rogers Communications Inc. - VP, IR

Thanks, operator. Good morning everyone. Thank you for joining us for the Rogers' third quarter '09 investment community teleconference. Bruce Mann here. Joining me in Toronto today on the call are Nadir Mohamed, Rogers' President and Chief Executive Officer, Bill Linton, our Chief Financial Officer, Rob Bruce, our President of our Communications division, Edward Rogers, who is our Deputy Chairman and Executive Vice President, Tony Viner, of Rogers Media, and Bob Berner, our Chief Technology Officer. We released our third quarter results earlier this morning. The purpose of the call is to provide you with some additional background, and answer as many of your questions as time permits. Today's discussion will no doubt touch on estimates and other forward-looking types of information. Our actual results could be very different than what we talk about. And as such, would you please review the cautions in today's earnings release, and also in our 2008 full year MD&A.

There are various factors and assumptions and risks with respect to these kinds of statements, and how our results could be different. And those cautions apply equally to the dialogue we will have over the next little while on the call this morning. So if you don't already have a copy of the earnings release or our annual report, they are both available on the IR site of Rogers.com. They are on EDGAR, and they are on SEDAR as well. So with that, let me turn it over to Nadir Mohamed, and then Bill Linton for some brief introductory remarks, and then the management team will take your questions. So over to you, Nadir.

Nadir Mohamed - Rogers Communications Inc. - President and CEO

Thanks, Bruce. And good morning everyone and thank you for joining us. As you can see from this morning's release our third quarter results represent a healthy balance of growth, cost control and margin expansion with double digit increases in both cash flow generation and cash returns to shareholders. Let me highlight a few of the key items in the quarter. First, solid revenue growth in both the Wireless and Cable operations of 7% over Q3 of last year. The most significant driver of the acceleration in top line growth was the record high growth in our Wireless data revenues, which in the third quarter alone were \$372 million, up 46% from Q3 '08.

And that represents about 23% of wireless network revenue. That's an increase of \$116 million year-over-year, and up almost \$60 million sequentially from Q2. We're on track to well exceed \$1 billion for the year. This reflects the strong success of the Smartphone investments we have made over the past several quarters. And the fact, that we have now lapsed some of the data price changes we made in 2008. Our accelerated upfront investments over the past several quarters in getting an increasing portion of our base on to a higher ARPU, higher lifetime value Smartphone devices and plans are proving successful. And today, approximately 28% of our postpaid base is smartphone subscribers almost doubled the 15% levels we were at last year. And in this quarter, we activated an additional 370,000 devices, predominantly BlackBerry iPhone and Android.

Secondly our heightened focus on costs, both operating costs and capital stands out in the quarter. What should be clear is this. With the slow down in our top line growth we have been successfully driving cost efficiencies to maintain margins as we continue to invest in high value customers and grow earnings and cash flow. This combined with our continued healthy top line growth, despite the recession environment enabled us to deliver excellent margin expansion, resulting in 15% consolidated adjusted operating profit growth. I had at the beginning of the year highlighted our focus on free cash flow growth. And in the quarter we delivered double digit increases in free cash flow and cash return to shareholders which Bill in a couple minutes will address further.

The third item I'll touch on is the internal reorganization we announced on September 16th regarding the further integration of our Wireless and Cable businesses. This builds on a journey we began several years ago. And one in which we have already had benefits from in many ways. These changes are designed to drive further enhancements to customer experience, to improve our time to market, and to make for a more effective and efficient business, so we can continue to compete, win and deliver sector-leading growth as we go forward. By further integrating our marketing sales service and network organization, we will be much better positioned to move quickly and seamlessly to address change in customer needs.

These changes are first and more most about becoming more effective and nimble as an organization. My first priority is we get the structure right and team right, to make it easier for our customers to engage with us, and our employees to more efficiently work together. It isn't and of

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itself about cost reduction, which is clearly a separate and ongoing priority around which we're making meaningful progress. Having said that, as we are rolling out our organization we are taking the opportunity to streamline management and streamline our operations. As a result of the integration and flattening of the organization, we are reducing the number of management layers and eliminating duplication, much of it at the more senior levels. And we have eliminated approximately 20% of positions at the Vice President level and above across the combined Wireless and Cable organizations. While this is still work in progress, we expect that reductions below the senior management level will represent a very small percentage of our work force in the low single digits.

Last item before touching on the operations, is that I believe we were successful during the quarter solidifying our network leadership positions for both Wireless and Cable. At Wireless we launched our innovative HSPA+ 21 Mbps Wireless data network. By the way the first and the fastest in North America, and one of the most advanced in the world. And at Cable we turned on our new DOCSIS 3.0 platform with the launch of a 50 Mbps high-speed Cable internet access service. We have the fastest and most reliable Wireless and broadband networks period, and that is not going to change.

Turning now to more of an operational view. On the Wireless front as you can see from the release, strong sub numbers both gross and net, and high value, with 70% of our gross adds and 80% of our net adds being postpaid subs. Again you this quarter you see the result of a combined focus on network excellence, service quality and product innovation in our churn results, where postpaid churn is down again year-over-year to just 1.06%. At the same time due in large part to the weak economy, we continue to see a deceleration in discretionary types of usage, especially roaming and out of bucket minutes, as well as slowing LD which together were significant drag on overall voice ARPU. Roaming in particular has continued to decline year-over-year, corresponding with the recessionary decline in business travel, and increases in unemployment, and for the quarter was down approximately 20%.

With aggressive cost management and fewer existing subs upgrading to iPhones this quarter than last year, we delivered a very solid 51% Wireless network margin. So overall a strong quarter for Wireless, highlighted by strong Wireless data growth and cost management, resulting in year-over-year adjusted operating profit growth of 22%. On the Cable operation side, solid top line growth of 7% with adjusted operating profit of 8% on 30 basis points of margin expansion. So further operating leverage, and again this quarter strong unlevered free cash flow growth of 26% year-over-year. The Cable team continued to do a good job of capturing meaningful cost savings, which has enabled to continue growth in profitability despite the top line slow down.

On the Cable subscriber front, the results were improved from second quarter but still down significantly from Q3 of 2008. The relatively deep Ontario recession, where 90% of our Cable business is located is obviously not helping. But the reality is also that Rogers' penetration levels across all of our Cable services are some of the highest in the Cable industry. So at the margin, it's clearly more difficult to continue to deliver the same growth rates that we had earlier along the curve. I do believe by the way, that we have an opportunity to gain some subscribers and make some inroads in the Cable side in the small business segment as we go forward.

On the Media side, for the most part a continuation of what we have been experiencing since probably mid of 2008, with declines in advertising and consumer discretionary spending weighing across our portfolio. However for the first time in more than a year late in the quarter, we saw some moderating in the ad market slow down, and sales of the shopping channel beginning to show some signs of life, trends that have continued so far into Q4. So the first time in more than a year, we have a bit of optimism brewing around our broadcast and televised shopping businesses. It's too early to call a turn in the ad market, but clearly they're encouraging signs. That's definitely being helped by some very strong ratings from Tony's team at radio that's been generating very positive results, exceptionally strong prime time audience delivery on the broadcast side, and continued strong results from our Sportsnet franchise.

The Media team has also aggressively implemented cost reductions across all of its divisions for multiple quarters now, while at the same time selective investing and laying the ground work to grow share when the economic cycle turns. And I'm confident that we will be working from a base that will have considerable operating leverage when the market begins to turn back up. I'll just conclude by saying that overall, we're well positioned and the strength of our franchise is reflected in our performance. Strong market share, solid margins and cash flow growth. We're building on our operating and financial strength by staying focused on execution, investing in high value customers, and our network advantage and managing our cost structure in a way that allows us to deliver cash flow growth in the context of a challenging economy and slowing growth. Let me now turn it over to Bill Linton, then we will take your questions.

Bill Linton - Rogers Communications Inc. - EVP Finance and CFO

Thank you Nadir. A few quick comments on the financial results of the quarter. Let me begin by highlighting our core Wireless and Cable businesses, which both grew by 7% year-over-year. That's up sequentially from the 6% growth in these two units in Q2 '09. Now this solid



growth was offset by lower negative margin, Wireless equipment revenue versus last year which was the result of fewer hardware upgrades by existing Rogers customers to iPhones in the current quarter. And also some year-over-year revenue declines at RBS and at Media from the continuing challenges in the economic environment. So overall, consolidated revenue growth was 2% as a result.

We recorded an adjusted operating profit of \$1.18 billion on consolidated basis, which is up 15% year-over-year, and represented 450 basis points of operating profit margin expansion. In terms of comps we have now lapsed Q3 '08 when we first introduced the iPhone, and when the economy began cycling down at an accelerated rate. These very healthy results also reflect not just acceleration in Wireless data revenues which Nadir spoke to a moment ago, but also importantly very significant progress around cost controls in all three of our businesses. At Wireless, good cost containment across both sales and marketing, and general and administration costs despite increased investments in customer care. And obviously cost of equipment sales being down meaningfully, together, enabled us to grow Wireless adjusted operating profit 22%, and expand the Wireless margins a full 630 basis points to 51%.

At Cable operations we grew adjusted operating profit by 8%, and expanded margins by a further 30 basis points to 42%. This represents the ninth straight quarter of year-over-year margin expansion for Cable operations. At Media also significant continued cost reductions which have been ongoing now since late 2008. And the media business is poised to show meaningful operating leverage as advertising revenues begin to bounce back with the economy. We also had good cost controls in terms of CapEx, with year-to-date declines at all three business units which is what enabled us to pull forward the CapEx to accelerate our HSPA 21 Mbps launch within our current year's budget and our current year's guidance. So year-over-year unlevered free cash flow of 28% and 26% respectively at Wireless and Cable operations.

Now the increase you see in corporate CapEx for the most part, reflects work on our consolidated billing system project. This IT spending was included in 2009 guidance and you will see continue at the corporate level for the remainder of this year and next, although the level may fluctuate somewhat from quarter to quarter. Net net operating free cash flow on consolidated basis for the third quarter, which is adjusted operating profit less CapEx and interest expense, was \$524 million which is up a very solid 19% year-over-year.

In terms of the main items below the adjusted operating profit line on the income statement, that impacted the year-over-year growth in net income and earnings per share. I'll point out that there was a \$72 million foreign exchange gain, which was partially offset by the change in the value of related derivative instruments. The net of these two currency related shifts, resulting from increased strength in the Canadian dollar in the quarter, contributed about \$40 million to the year-over-year increase in adjusted net income.

We also recorded a year-over-year increase in income tax expense, primarily related to items recorded in the third quarter of last year, including the impact of the Federal and Ontario income tax harmonization, and certain income tax valuation allowance adjustments. As you can see from the lower effective tax rate in Q3 of last year of only 2.8% versus 21% in the current quarter. These items together with the growth in operating profit and the lower number of shares outstanding as a result of our share buyback program, resulted in adjusted earnings per share of \$0.82 which is up 12% from Q3 of '08.

On an un-adjusted basis, a couple other items I'd point out would be the \$68 million swing in stock base compensation moving from a large recovery position in Q3 '08 to a modest noncash expense position this quarter. Additionally, we recorded \$11 million of integration and restructuring expenses in the quarter. This item primarily reflects severances that occurred during the latter part of the quarter associated with reorganization of our Communications group. And also certain transition costs associated with our IT infrastructure outsourcing agreement with IBM. I'll mention that we expect to record additional below the line integration and restructuring expenses in the fourth quarter of this year, as we work towards completing the reorganization of the Communications group. But I can't yet quantify for you the amount. Also in the quarter, we recorded a \$12 million termination fee related to a Blue Jays player contract.

In terms of the part two regulatory fees, as you know the CRTC is expected to amend its regulation of these fees. And we estimate that on a going forward basis, they will be roughly one third less than the current rates. We have been accruing these fees for the last three broadcast years which end in August at an annual rate of about \$27 million, including both Cable and Media. In Q4, we expect to reverse accrued amounts for '07, '08 and '09 broadcast years totaling about \$80 million. Most of the amount, the portions related to '07 and '08 will be below the adjusted operating profit line. And the current year portion will be reversed above the line, and the Q4 and go forward accrual rates will be reduced by approximately one third as I referred to a moment ago.

On the balance sheet, you will see \$430 million now classified as current portion of long-term debt. This relates to the fact that we intend to redeem our US \$400 million 8% notes, at a premium of 102 during the fourth quarter. In terms of cash returns to shareholders, during the third quarter we bought back 13.9 million RCI shares for a total of \$408 million under our share buyback program. Year-to-date as of the end of September, we had repurchased just over 30 million shares for \$917 million, and paid out dividends during the period of another \$527 million. So

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cash return to shareholders, so far this year of more than \$1.4 billion, reflecting the 16% dividend increase earlier this year, and execution to date of the largest share buyback the Company has ever done.

Overall, we continue to be in a very strong position financially, we have investment grade ratings, and relatively low leverage at approximately two times debt to EBITDA. We have a full \$2.4 billion of liquidity under our fully committed multi-year bank facility. And we have no material debt maturities until mid-2011. So whether you look at leverage, liquidity or refinancing requirements, we continue to be in a very solid position from a balance sheet and financial flexibility perspective. With that, I'll pass it back to Bruce and the operator so we can take your questions.

Bruce Mann - Rogers Communications Inc. - VP, IR

Thanks Bill. And Operator, we will be ready to take questions from the participants in just a moment. But quickly before we start, the management team here would just ask as we do on each of these calls that those participants that are going to be asking questions, be frankly courteous to all the other participants and limit the questions to one topic and to one part, so that as many people as possible have a chance to participate. And then to the extent we have time, we will circle back and take additional questions, or we will get them answered for you separately after the call. And with that, operator, would you quickly explain how you would like the participants to organize the Q&A polling.

QUESTION AND ANSWER

Operator

Thank you.

(Operator Instructions)

Your first question comes from Jim Breen of Thomas Weisel Partners. Please go ahead.

James Breen - Thomas Weisel Partners - Analyst

Thanks. Just with respect to the network, obviously here in the US, AT&T is obviously taking some flack for network quality, post the iPhone. We haven't heard it yet from you guys up there. I was wondering if there are things you did on the network side, heading into the launch last year. And then with the 3G roll-out this year, did you kind of bolster the network pre the iPhone launch, thanks.

Bob Berner - Rogers Communications Inc. - EVP, Chief Technology Officer

Hi Jim, it's Bob Berner here. Yes, I mean there's a number of factors that affect network performance. I think we're well positioned in all of them. Firstly, in terms of quality, Rogers deployed our 3G network in all markets at 850 MHz, and that gave us a better building penetration and reach. As you know most carriers deployed in higher frequencies, which provides a greater degree of challenge in system quality. We're also deploying at 1900 MHz for additional capacity, but we have both frequencies in all markets. And that means our voice and data will move back and forth between those frequencies, giving our customers the best quality and data speeds at any point in time.

In terms of capacity, if you don't have enough capacity in the market that impacts quality and that impacts your data speeds. This is the greatest challenge for all mobile operators is to achieve these broadband data rates, is to implement enough backhaul capacity. Now, Rogers invested upfront in backhaul we launched 3G with more backhaul capacity, than the vast majority of 3G operators around the world. Our backhaul, at the go, supported data rates at every step of the network and data capabilities and device capabilities from the initial 1.8 Mbps a couple years ago, right up to the 7.2 Mbps that we've already deployed nationally.

For HSPA+ at 21 Mbps, we've deployed and continue to deploy a combination of high capacity microwave radios that support up to 300 Mbps per site along with fiber-optic transmission to our end sites and aggregation points. And we started two years ago to re-architect our entire transport network to an all IP network that supports mobile data traffic well into next generation. Now, customer demand, Rogers was the first carrier to launch broadband data to the home, the first carrier. And we learned a lot about customer usage patterns that we were able to apply to our mobile Wireless networks, and to predict what that usage would be in a very effective manner. From a customer experience perspective we

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have had 7.2 Mbps in market for almost a year and a half. And we were the first in North America to deploy 21. Many carriers are just now deploying 7.2 Mbps in selected markets. So we have got the capacity in place, we've got site density in place, we have radio spectrum position, both in terms of the best frequency and the right quantities. Does that help?

Nadir Mohamed - Rogers Communications Inc. - President and CEO

Jim, he forgot to mention that he's the best manager of networks in the world.

James Breen - Thomas Weisel Partners - Analyst

Thanks. Just one quick follow up on the ARPU's. Nadir mentioned that the roaming LD was still down 20% year-over-year. Yet your consolidated post-base ARPU's down about a little over 2%. Can you give us any color in terms of what the ARPU sort of looks like when you factor out LD and roaming, sort of the iPhone effect on the higher ARPU levels?

Rob Bruce - Rogers Communications Inc. - President, Communications

You were breaking up just a little bit at the end. Did you say what the ARPU's would look like if you took out the LD and roaming piece?

James Breen - Thomas Weisel Partners - Analyst

Yes, just to the impact -- just to get a feeling for what the impact has been from the Smartphones being no longer part of the base.

Rob Bruce - Rogers Communications Inc. - President, Communications

Think of the impact of roaming being a couple dollars, roaming and LD being roughly \$3 impact on the ARPU.

James Breen - Thomas Weisel Partners - Analyst

Great, thank you.

Operator

Your next question comes from Jonathan Alan of RBC Capital Markets, please go ahead.

Jonathon Alan - RBC Capital Markets - Analyst

Thanks very much. A question for you on enterprise telecom. A few years back after you brought in Bill, and bought Call-Net, you made, Rogers made an effort at first to get into the medium and larger enterprise space, then pulled back after a year or so of trying. I'm just wondering, particularly now with Edward's new role running RBS, and also involved in some of the M&A activity, I'm wondering what Rogers appetite might be to get back, and expand beyond just the small, medium business, and get back into the larger enterprise space. Particularly, if either organically through maybe partnering with Shaw or other cable companies or whether Rogers would have an appetite to acquire some of the network and expertise to get into that business?

Nadir Mohamed - Rogers Communications Inc. - President and CEO

This is Nadir, I should start by saying what I hope is obvious to everybody, the change in the role of the organizations by no means suggest a change in strategy or focus in terms of positions. But we are looking to have Edward spend more time, so we're building growth platform, but it doesn't in any way signal a change our emphasis on M&A or any strategic shift. I think, going back to your RBS question, obviously we have been repositioning RBS. And let me remind everybody of the strategy for RBS, which is being very much played in the space on net. In other



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words, move up from resale to on net. It gives you a sense of what markets that would make sense for us to be in, that would largely be in Ontario and the Atlantic where we have got networks.

We have also said the key segment for us are sort of the small and mid-segment. Frankly Jon, from Wireless and Wireline I was worried about trophy accounts on the enterprise side, that's the domain of the large companies, the phone companies, not a space you can win without pricing your way down. And the last piece, is our interest very much is on IP, not on legacy wireline. Legacy wireline is not where we would see growth. I think the focus remains IP, small, on-net, and for IP. And one of the things that I know we have been working hard on is actually improving RBS. And I wouldn't mind Edward giving an update on the performance.

Edward Rogers - Rogers Communications Inc. – Deputy Chairman and EVP

Sure, well thank you. I think too, when we talked about what the priorities are, it's in terms of the scale to Rogers. Obviously the Cable and Wireless progress that we're going to sell to the smaller business group will be a bigger revenue piece in total, than our existing larger enterprise business. As we've said, we continue to concentrate on the business that we have, and we're refocusing that as has been said. And we're reinvesting in certain areas that meet our strategy and the focus. And as we kind of get up to speed on that strategy, we will kind of look to the future, but our focus today is kind of on the business that we have.

On growing where it makes sense, on bidding on RFP's that make sense. We generally won't if it doesn't make sense, and we won't fight on price, but there are accounts that do. And we focused on cost structure and kind of right sizing the cost structure. Some of the EBITDA, I mean there was kind of two phases to it. One was pulling back from the original strategy and taking out costs. We saw good bump in EBITDA in 2008. And this year we continue as there is some revenue pressure on that business unit. But now as we place some large bets on some areas, we see some pressure on the overall EBITDA in 2009. But we hope to look to grow that business unit in EBITDA as we go forward.

Bruce Mann - Rogers Communications Inc. - VP, IR

Next question operator.

Operator

Your question comes from Jeff Fan of Scotia Capital, please go ahead.

Jeff Fan - Scotia Capital - Analyst

Thanks very much, and good morning to everyone. Just on -- along the same lines of enterprise, with Bell and TELUS coming in with their new network and HSPA devices specifically into the enterprise. And presumably you guys have a pretty good market share in the enterprise business especially on Smartphones and BlackBerry's over the years. Just wondering how you plan to keep those customers, maybe give us some stats on the contracts or that you have in place. And whether there are any relationships out there that you can strengthen i.e., I guess the MTS Allstream MVNO agreement whether that's sufficient for you to maintain your lead in the corporate segment especially on the BlackBerry's.

Nadir Mohamed - Rogers Communications Inc. - President and CEO

Let me lead, then maybe look to Rob to fill in any specifics. But it's interesting when we really started going after the data side of our business two years ago, we made it very clear to all our channel distribution approach that the key focus even then was on small and mid. To the point I made earlier the concern has always been at the large enterprise level, pricing becomes unfortunately too much of a lever as opposed to value. Having said that, in the early days clearly we had an advantage with data and roaming. But to be honest on the BlackBerry front which obviously has been the key device in that market, the other guys have had BlackBerry for sometime now that allow people to roam.

So, that's an issue that we have already had to face. I think we come back to our reliability claims, our speed of network. It's one thing to have a new network, but to actually have a network that has the quality that we do and the speed that we do. So we will rely on our core differentiation to come into play in that market. But we shouldn't let anybody kind of assume anything other than, we actually have been a market share in the small and mid segment. And relatively speaking the other guys tend to dominate on the enterprise side.



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Operator

Your next question comes from Simon Flannery of Morgan Stanley, please go ahead.

Simon Flannery - Morgan Stanley - Analyst

Good morning everybody. I wanted to touch on wire line margins if I could, it looked very impressive back about the 50% level. I understand about the drivers on less iPhone upgrades. As we think about getting into Q4 and some of the dynamics we were talking about on the HSPA launches. Then into early next year, it would seem that the pressure on handset subsidies may lessen somewhat unless you start cutting prices aggressively. So I guess the question is, are we likely -- are there anything in these numbers, the 51% or so that is sort of unsustainable beyond sort of reasonable seasonality? Or could we start to see margins sort of be -- remain at these higher levels? Certainly AT&T has been talking about margins going from sort of 38% level to a mid 40s level over the next several years as some of the iPhone subsidy sort of unwinds? Any sort of color about direction there would be great thanks.

Rob Bruce - Rogers Communications Inc. - President, Communications

Thank you, this is Rob Bruce. Simon, obviously as Nadir referenced, a lot of the positive move in margin into the 51 range was a result of our focus on continuing to cut costs in the quarter. As you saw in the quarter, costs in handsets were reduced minus 2% against base growth of 8%. We are going to continue to stay very focused in what we think is still a fragile economy on driving costs down. We are going to work hard on that. Going in the other direction however, I think that probably starting late in the Q4 or mid Q4 and early next year for sure we expect a lot more activity from new entrants. I think that in fact will push margins the other way, and I think in reality over time we should see margins migrating down towards the mid 40s, and that's kind of the prognosis as we see it.

Simon Flannery - Morgan Stanley - Analyst

Thank you.

Operator

And your next question comes from Vince Valentini of TD Newcrest, please go ahead.

Vince Valentini - TD Newcrest - Analyst

Yes, thanks. I have a question on what Shaw said last week. But first let me just clarify, a couple questions on the MTS there. Can you confirm, is that deal between you on the roaming side and the MVNO side, has that been finalized and signed now? Or is it still pending?

Nadir Mohamed - Rogers Communications Inc. - President and CEO

It was finalized and signed we announced it back on our last conference call. So it was a done deal then.

Vince Valentini - TD Newcrest - Analyst

Okay, great.

Nadir Mohamed - Rogers Communications Inc. - President and CEO

They have not launched an MVNO. They have the opportunity to launch an MVNO as a result of that contract.

Vince Valentini - TD Newcrest - Analyst

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Great. And you probably heard last Friday, Jim Shaw said he would be open to discussion with Rogers about some sort of partnership in Wireless. And he said he may be talking to you guys soon. Can you give us your thoughts on mutual benefits of partnering with new entrants, as opposed to competing with them, and where or where not you may be on discussions?

Nadir Mohamed - Rogers Communications Inc. - President and CEO

I would start with, we would definitely welcome discussions with Jim at any time as well. Edward and I are both smiling.

Rob Bruce - Rogers Communications Inc. - President, Communications

And listen, I think you can see from what we have done with MTS, we believe that anything we can do to share networks to reduce capital and deliver better networks and better services to our customers on very close to our heart. Obviously we embrace the opportunity to partner with Shaw or anybody else frankly, who is interested in sharing quality network and helping us reduce CapEx.

Vince Valentini - TD Newcrest - Analyst

Great, thanks.

Operator

And your next question comes from Randal Rudniski of Credit Suisse please go ahead.

Randall Rudniski - Credit Suisse - Analyst

Thanks. A question on Wireless data, in the quarter there was a very large sequential improvement in data revenues, and continued strong year-over-year growth. Can you help us understand what drove the improvement in the sequential revenue Wireless data?

Rob Bruce - Rogers Communications Inc. - President, Communications

Randal, it's Rob. Listen, it really came strongly from a few places, quite just frankly from where you would expect. A very large portion of it came, almost equal in size, from Smartphones, and the continued growth of Smartphones and the revenue that came from Smartphones. So think of that as 40%. Another 40% coming from the continued growth in SMS. And I should stop and pause and say the change to the way we bill SMS only accounted for about \$7.5 million of that. So a really significant portion, 40% of that would be from SMS. And then the remainder from other areas including data roaming and the like, which account for virtually all of it.

Randall Rudniski - Credit Suisse - Analyst

Okay. Thank you.

Operator

Your next question comes from Greg MacDonald of National Bank Financial, please go ahead.

Greg MacDonald - National Bank Financial - Analyst

Thanks, good morning guys. Can we jump back to the Wireless margin for just a second. What I'm trying to do, is in addition to Simon Flannery's question, trying to understand what happened this quarter vis-à-vis the mix. And so let me sort of set it up. A \$100 million decrease in cost of sales, yet you actually saw gross adds at 370,000, versus what I think was 255,000 in the third quarter last year, correct me if I am wrong.



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And you have got an increase in gross adds in Smartphones, yet a decrease in the absolute numbers of cost of sales which is actually pretty big. Is there something going on here vis-à-vis mix? Are the gross iPhone gross adds a lot less, than other less expensive or other less subsidized phone a lot higher, so is there a mix issue? And what does that mean for subsidies on a go forward basis, as we are going into a 4Q, where TELUS and Bell are actually going to be selling iPhones, thanks.

Rob Bruce - Rogers Communications Inc. - President, Communications

Listen, I didn't hear your entire question perfectly. But one of the key things I think that was omitted in your comments was a big reduction in iPhone HUPs during the quarter. And HUPs in general were down pretty significantly which had a really positive effect on EBITDA.

Greg MacDonald - National Bank Financial - Analyst

So if I'm trying to extrapolate, you said 45% of gross adds for Smartphones overall, or for iPhone.

Rob Bruce - Rogers Communications Inc. - President, Communications

No, 45 for Smartphones overall. Down a little less than, a little more than half of that for iPhone.

Greg MacDonald - National Bank Financial - Analyst

Okay. So there really is mix issue going on as well.

Nadir Mohamed - Rogers Communications Inc. - President and CEO

It's both the HUPs and also the mix between iPhones and BlackBerry

Greg MacDonald - National Bank Financial - Analyst

Okay

Nadir Mohamed - Rogers Communications Inc. - President and CEO

Which as you know last year Q3 was our first iPhone quarter, and we had probably the highest percentage in terms of upgrades. So by that definition, you got both working, one is the lower level of HUPs that Rob referred to, and the change in mix between BlackBerry and iPhone.

Greg MacDonald - National Bank Financial - Analyst

Okay. Then quick clarification question or detail. Is there some point soon are you going to start breaking out the wholesale segment of Wireless?

Rob Bruce - Rogers Communications Inc. - President, Communications

Greg, probably something that we will look at as we have these roaming deals that will start contributing more material set of numbers. But obviously not something that we're doing now, but it makes sense in the context of 2010. I'm not saying we will, but I'm sure working with Bill we will figure out what the right timing is. It's logical over time, I know south of the border, people have already started breaking out wholesale.

Nadir Mohamed - Rogers Communications Inc. - President and CEO

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And it would be helpful for anyone that's listening, just as a matter of context, HUPs is secret code arrived for hardware upgrade program. (Laughter)

Greg MacDonald - *National Bank Financial - Analyst*

Thank you.

Bruce Mann - *Rogers Communications Inc. - VP, IR*

Next question.

Operator

Your next question comes from Dvai Ghose of Genuity Capital Markets, please go ahead.

Dvai Ghose - *Genuity Capital Markets - Analyst*

Yes, thanks very much. I think for what you said you sold 255,000 iPhones in Q3 '08, 185,000 in Q3 '09. So to what extent was that a shortage of iPhones in the quarter, a reduced demand, or indeed a conscious effort by the Company to manage margins? Because it certainly seems that your non iPhone Smartphone such as BlackBerry's generate much better returns because the ARPU's similar, the subsidy is obviously much less on the BlackBerry's, and it seems the network expenses are less because BlackBerry supports you, and the CapEx is probably less as will, because the iPhone is the mother of all bandwidth hog. Was this a conscious attempt.

Rob Bruce - *Rogers Communications Inc. - President, Communications*

Dvai, I don't think we actually provided you those numbers. But --

Dvai Ghose - *Genuity Capital Markets - Analyst*

I'm sorry, I thought you said half of the 370 were iPhones.

Rob Bruce - *Rogers Communications Inc. - President, Communications*

Approximately.

Dvai Ghose - *Genuity Capital Markets - Analyst*

Okay.

Rob Bruce - *Rogers Communications Inc. - President, Communications*

Sorry, I just couldn't track exactly where you got that number from. To answer your question, the focus on iPhones, we had ample inventory by the end of the quarter. So we caught up with respect to our backlog. And in terms of restraining upgrades in the base, we didn't restrain our customers who wanted to get iPhones from getting iPhones. So just over time, gradually seeing more and more of a shift back towards the iPhones that we put in place, are more on the acquisition side, as our base gets more heavily penetrated with iPhones. So that's probably the full story.

Nadir Mohamed - *Rogers Communications Inc. - President and CEO*



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And Dvai, so just to give you the strength in the market, we should point out that compared to Q2 of this year, so sequentially in Q2 our smart devices were 315,000. And in this quarter we're at 370,000, so clearly still a pretty good market and pretty good growth.

Dvai Ghose - Genuity Capital Markets - Analyst

Yes, just quick follow up if I may. It seems that you are, for example, with the BlackBerry Bold 9700 pricing it pretty high at about \$300, a reduced subsidy, is this also part of a strategy to perhaps give up some of the market share to Bell and TELUS in order to reduce the overall subsidy burden?

Rob Bruce - Rogers Communications Inc. - President, Communications

Yes, listen, we're in the game of winning high value customers. We try to price devices intelligently, and reflective of what they cost. So that's really more the way we make decisions, Dvai.

Operator

Your next question comes from Glen Campbell of Bank of America Merrill Lynch, please go ahead.

Glen Campbell - BAS-ML - Analyst

Thanks very much. My question is for Bob Berner. You have clearly done a great job thinking ahead about data use, data traffic growth. Can you talk about what sort of growth you're actually seeing in the market? We have seen interesting data points from other carriers. As just as a related question, if you wanted to keep CapEx to sales and Wireless down in that say, comfortable low teens range, how fast could data continue to grow year-over-year? I mean, could we take a doubling for the next three, four years? Could it be faster than that? What -- where would you start to pain point where CapEx would likely have to rise?

Bob Berner - Rogers Communications Inc. - EVP, Chief Technology Officer

Glen, I'll take the two issues in the order that you asked them. Data growth in broadband is clearly very high because starting point was very low. Up until 3G, where we changed the sort of user experience from what we had on (inaudible) as an edge to a true broadband experience, the total data traffic was relatively small proportion of our total traffic. The growth has been very significant as you can imagine, but the majority of capacity is to roll out the initial networks. And so as we establish the footprint, put in the backhaul, and establish the capability, incremental CapEx for more capacity drops per unit cost dramatically. So we can grow that demand or capacity to match demand very easily within our guidance going forward. And we don't anticipate that there's going to be any significant dollars going into proportionate capacity growth beyond sort of linear pattern.

Rob Bruce - Rogers Communications Inc. - President, Communications

So if I can just chime in Glen, it's Rob again. Listen I think the one thing that is important to remember in a discussion with Rogers is we're not flat-rated, and that we love to see the data growth because that data growth translates into data revenue for us, and we continue to be excited about that. What's more is we're very confident that the margins we're getting on that data are accretive to the businesses that we run. So again we expect data will continue to grow. I think Bob's in a position and done a great job so far in terms of facilitating that growth with all the appropriate preparation on the network, and we'd be excited to see more because we could take it to the bank.

Glen Campbell - BAS-ML - Analyst

Okay. Thanks very much.

Operator



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Your next question comes from Bob Bek of CIBC, please go ahead.

Bob Bek - CIBC World Markets - Analyst

Thanks, good morning. Bill, I wondered if you could perhaps update us on the view of cash taxes going forward. I saw the taxes hit home in Q3. And I guess related to that, perhaps Nadir, if you could talk more about the use of cash flow has been material towards the buyback recently. And your thoughts on that versus a dividend or board's thoughts on the dividend going forward, thanks very much.

Bill Linton - Rogers Communications Inc. - SVP, Finance and CFO

Sure. We are going to, as you saw this quarter start recording taxes as currently payable, which means you would be paying them within the next 12 months. However, due to some good structuring the actual payments aren't going to be for another year after that. So we won't start paying significant amounts of cash taxes until 2011. But we will be close to fully taxable in that year.

Bob Bek - CIBC World Markets - Analyst

Okay, thanks. And Nadir, use of cash?

Nadir Mohamed - Rogers Communications Inc. - President and CEO

At this point more of general fund going into a planning cycle, something we will work with more. But earlier on in the year, we articulated our capital policy in terms of direction on leverage, two to two and a half times. But sets the stage given that, and the cash flow that we expect to continue to deliver, that things like buyback and dividend would be part of the mix. We also made reference to the general idea that you pay dividends on growth along with what your expectations for cash flow growth would be. I think by definition, one has to be sensitive to not looking at a short-term perspective, but looking at dividends as something that need to reflect trends cash flow over a number of years. So probably premature to give any specific, but history would say that those have been areas, that I think in the last couple years we have demonstrated a key way for us to give back to shareholders.

Bob Bek - CIBC World Markets - Analyst

Thank you.

Operator

Ladies and gentlemen we have time for two final questions. The first of which will come from Rob Goff of Haywood Securities, please go ahead.

Rob Goff - Haywood Securities Inc. - Analyst

Thank you very much. My question would be on the Wireless data. You have gone from 15% to 28% penetration on Smartphones. Do you see that slowing or is 40% is a good target to look for 12 months out?

Rob Bruce - Rogers Communications Inc. - President, Communications

We're at 28% penetration now, and I missed the last bit, Rob can you say it again.

Rob Goff - Haywood Securities Inc. - Analyst

Sorry. Do you see 40% as a good target looking 12 to 15 months out with respect to the momentum on the Smartphone penetration?



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Rob Bruce - Rogers Communications Inc. - President, Communications

I would say it could take a little bit longer than that. Right now as you know we're running about 45% of our gross just roughly on Smartphones. And I think it's quite conceivable we will get to 40 plus in the not too distant future though.

Rob Goff - Haywood Securities Inc. - Analyst

Okay, thank you very much.

Operator

And your next question comes from Tim Casey of BMO Capital Markets, please go ahead.

Tim Casey - BMO Capital Markets - Analyst

Thanks. You mentioned in your Media comments that you have seen a reversal of trend, although you're down, you're starting to see some indications of some optimism. I'm just wondering if that is across the board or if it's still spotty, and if we can extrapolate that into some of the other businesses. Are you seeing an improvement in trend in some of those discretionary buckets in Wireless? And also for Tony, could you characterize any interest you have in the CanWest assets, do you have an active M&A file on the Media side thanks.

Tony Viner - Rogers Communications Inc. - President, Media

Tim, with respect to the strengthening, I'd like to declare the recession over, but I can't. We are seeing some strengthening as we said in the release in the shopping channel, and we have really enjoyed some good results as a result of much improved audience delivery at City television. So and some stabilization in our radio growth. So it looks better than it did before, but as we had said with respect to our other businesses a lot of that has to do with the comparables that we had a year ago. With respect to the CanWest assets, we have always maintained we're in the Media business, and we would like to be opportunistic. If an opportunity arose we would certainly look at it, but we have no specific interest in any of those assets at this time.

Rob Bruce - Rogers Communications Inc. - President, Communications

Tim, it's Rob just as a follow up, we really continue to feel the pinch on discretionary revenues in the Wireless business at this point. Or no obvious changes in the economy for sure. So right now, we will wait and watch and look for some more hopeful signs in subsequent quarters, and continue to stay very focused on cutting costs. Again good success this quarter with costs that minus 2% year-over-year against subscriber growth of 8%, so happy with the progress so far. But I think in light of where the economy is right now, we will keep our head down and focus on cost cutting.

Tim Casey - BMO Capital Markets - Analyst

Thank you.

Operator

Mr. Mann, please continue.

Bruce Mann - Rogers Communications Inc. - VP, IR

Well just quickly, the management team here at Rogers wants to thank everybody for participating this morning. We know it's a busy time of the quarter for everyone. But we, basically appreciate your interest, and your support and your coverage a lot, and we appreciate your making the



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time to join us this morning. If you have any questions that weren't answered on the call, give Dan Coombes or myself a call. Both of our contact info is on this morning's press release. And that concludes today's call, thank you very much.

Operator

Ladies and gentlemen, this concludes the conference call for today. Thank you for your participation, and you may now disconnect your lines.

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