BCE

Q3 2009 Results Conference Call

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November 12th, 2009

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the BCE's Third Quarter Results Conference Call. I would now like to turn the meeting over to Mr. Fotopoulos. Please go ahead.

Thane Fotopoulos

Thank you, Wayne. Good morning, everyone, and welcome to BCE's Third Quarter 2009 Analyst Conference Call. Joining me today is George Cope, President and Chief Executive Officer of BCE and Bell Canada, as well as Siim Vanaselja, our CFO.

A short time ago, we released our Q3 results and the purpose of the call today is to provide you with some additional colour on those results. George and Siim will take you through a slide presentation that's available on our website at bce.ca and then we'll move to a Q&A, where we'll answer as many of your questions as time permits.

As usual, before we begin, I would like to remind you that today's remarks will contain some forward-looking statements with respect to items including revenue, EBITDA, capital intensity, free cash flow, as well as adjusted EPS. These statements are subject to certain assumptions and there are risks that our actual results may differ materially from those contemplated by the forward-looking statements. For additional information on such assumptions and risks you can consults BCE's 2008 Annual MD&A, as updated in our quarterly 2009 MD&As, all of which have been filed with the Canadian securities commissions and with the SEC, and which are also available on the Investor Relations section of our website. Any forward-looking statements made today represent BCE's current expectations, and, accordingly are subject to change after such date. Except as may be required by Canadian securities laws, we do not undertake any obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise. And I'd like to note that I am making this cautionary statement on behalf of both George and Siim.

With that, I'll turn it over to George and then Siim for some introductory remarks and then we'll take your questions. George, over to you.

George Cope, President and Chief Executive Officer

Thanks, Thane. Good morning, everyone. Thank you for joining us this morning. I am actually now turned to what's called slide four - *HSPA Network Launched Ahead of Schedule* - and I'll go through from there on the presentation.

As everyone on the call I know would be aware, we did launch our network on November 4th, approximately three months ahead of schedule. Significant in Canada, as well for all Canadians, it is the fastest wireless network, not just in Canada but now available in North America. So any perception that the Canadian wireless industry lags in North America should be put to rest as of November 4th. We also launched the network with HSPA+ in a much larger footprint than one of our competitors—and we'll talk about that in a moment—giving us access to 21 Mbps speeds literally in everywhere that we've launched the network - through the 21 Mbps stick that's now available for the internet access marketplace.

We've launched the iPhone, and importantly, our roaming arrangement has begun with AT&T, such that people today getting off planes from the US are now roaming on Bell with their iPhones, even iPhones that they bought prior periods to Bell launching its network. So that ultimately will be important revenue for us.

Turning to slide five, just quickly you can see our coverage. We've made a significant investment in HSPA+; many more, thousands actually, of cities and towns covered ahead of our competitor, Rogers. You can see the difference is significant, and we have a unique competitive advantage, a coverage advantage that is unusual to have in the wireless industry these many years out. I'll also mention that HSPA+ will be covered in the area in Quebec today not covered early in Q1, even though we obviously have HSPA there today. You can see also in Western Canada a significant coverage advantage, with all of Western Canada there, in Alberta and BC, with HSPA+ relative to our specific competitor, Rogers.

Turning to slide seven, I also thought I would mention that we did make a strategic decision to build fibre to over 75% of the cell sites. In fact, all of the Tier 1 markets in Canada have fibre now built to the cell sites. That ensures us that we can handle some of the data demands we expect with the smartphone market acceleration. Certainly in conversations that we've had with AT&T, they've, and as people know, have made comments about the importance of ultimately building fibre to cell sites. We took that intent and applied it to our build-out. It gives us a competitive advantage again over one of our competitors, and also for our competitor to duplicate that, we estimate the capital program would be at least $150 million, given what we invested, and what we know our partner on this, TELUS, would have probably invested for their fibre.

Turning to page eight, important that the market understand that we have launched 12 HSPA devices. Combined with our EVDO network that we're still running, we now have 45 different handsets, a broad range of handsets. The only carrier in North America that has access to the iPhone, the Palm Pre and the Blackberry, and utilizing that in the marketplace today as we begin to look to accelerate our wireless business.

Turning now to the quarter, we had made measurable progress on all five of our strategic imperatives in the quarter. So we, first of all, if we turn to customer service, we are now completing Same Day Next Day service in over 91% of our households. And that improvement in service has seen a reduction in calls to our call centres now year-to-date of 21%, driving costs out of the business while improving service in the marketplace. Our second imperative of achieving a competitive cost structure continues to allow us to generate the type of margin stability and EBITDA growth that we're seeing, which is clearly significant than a number of our competitors on a North American basis at this point.

In the quarter, our labour force was reduced an additional 1,100 people, bringing our total reduction since the 100-day plan in June 2008 to a little over 5,000 Bell employees, and on a BCE-wide force, about 6,200. It is important to mention; it excludes, of course, our acquisition of The Source. Also in managing our cost structure, it also includes tight management of working capital. I thought I would highlight that our days outstanding have improved five days year-over-year in management of our accounts receivables, generating significant additional cash for us, and at the same time, have not seen an acceleration of bad debt year-over-year, even given the economy that we're in.

Turning to page 10, on the wireless side, we had our best Q3 postpaids ever. Our net adds overall, including prepaid, were up 15%. Importantly, as investors know, acceleration of market share has been a core strategy of ours. We're beginning to gain traction here where we gained 6.7% share year-over-year in the quarter. Data revenues continue to accelerate, and I mentioned already the launch of the new handsets.

On the Wireline side, we had our best TV quarter in many, many years. Bell TV revenue is up 10.2% and I think, most importantly, through very disciplined cost management, our Wireline EBITDA increased 2.1% in Q3. On the broadband side, we've talked about HSPA, the other key is that we continue to make our investment in FTTN, and in the GTA and the Greater Montreal area, we now have 80% of the population covered with fibre to the node.

Turning to slide 11, it's also encouraging for us to see that our strategy of improved branding, improving our distribution and focusing on product differentiation, such as our high-def TV product, is beginning to drive results in terms of our net adds. And you can see that our RGUs, excluding our NAS losses, were actually up 25% year-over-year to 197,000 in the quarter.

Turning to slide 12, on the wireless side, I mentioned already our strong growing results on the postpaid side, and of course, that's prior to us launching the HSPA network. Of concern continues to be the ARPU decline. The ARPU was up slightly from the second quarter, but year-over-year still down 4.6%, being driven by two key elements: one, the competitive landscape; and two, the drop in roaming revenue from travellers going both into the US and into Canada; and also I think it's worth adding a third point, that clearly the economy itself is just driving lower usage. Very pleased with our wireless data revenue growth at 33%, and that's prior to the launching of some of the additional smartphones that we now have on HSPA, so we'll look to continue to grow that. And I think, importantly for us, the ability to add approximately 60,000 gross adds year-over-year, yet reduce our COA 15%, and therefore, maintain our EBITDA margin, should clearly indicate to the street that our cost management process isn't just being applied to our ILEC, it's also being managed through our wireless business.

Turning to our voice portfolio, clearly a tough portfolio, but I think on a relative basis, doing okay. Our residential NAS losses did improve for the eighth consecutive quarter. We did have an increase in losses on the wholesale side, and on the business side. We believe the business erosion of NAS is economy driven, particularly in the small-medium business market where we continue to see no real growth in what we call in-orders, or new business creation. So we would anticipate a strengthened economy over time would bring that number back into historical trends. It is worth noting that in long distance we've also seen a contraction and a bit of an acceleration of decline in revenue there. We did outperform our competitors, who were anywhere from 12% to 14% decline year-over-year, but even so, we certainly have seen the impact of the economy on long distance pricing and usage.

Turning to our TV product, another very strong quarter, and it's continuing to confirm our strategy of focusing on product differentiation, branding and distribution differentiation, and not price. It's clearly working in this portfolio, where our ARPU is up 6.4% a year, but our net adds also are up to 40,000 net adds in the quarter; the strongest quarter we've had since the fourth quarter of 2005. And in continuing to maintain that leadership, we - a week ago - announced that we now have 100 HD channels available in the marketplace, the first provider in Canada to do that, and you can see we now have a significant advantage over our cable competitors in terms of HD leadership in the marketplace.

Turning to the Wireline data market, overall data revenue was down 2.4% year-over-year, really driven again by the slower economy on the business market side. Internet net adds were 22,000 versus 33,000 last year, in what's clearly a maturing product in terms of penetration. But retail residential net adds were up 23% year-over-year, so our retail group actually had a strong quarter. And our residential internet ARPU was up 8% year-over-year.

Looking forward, clearly our focus on driving out cost to maintain our margins has to continue to be the focus of the organization, as revenue in the telecom sector is clearly tough to come by these days. Also, our focus now on driving our wireless business with the new HSPA network launched, we look forward to bringing the Bell products and the Virgin products to The Source stores in the first quarter, and that The Source will also have access to smartphones such as the iPhone. It is worth noting that The Source acquisition is now executing our strategy of carrying the Bell TV product, and is accounting, some weeks, for up to 10% of our net adds on the TV business already, so we're beginning to see some of the benefits of that acquisition, even excluding the fact that we can't, at this point, put our wireless products in the stores until January. And clearly for us, we're looking forward to the branding opportunity we have on the Olympics coming in the early part of 2010.

So with that, let me turn the call over to Siim.

Siim Vanaselja, Chief Financial Officer

Thanks, George. Good morning, everyone. So I'll start with slide 19, and the financial overview for the quarter. I would say that, in looking at the quarter, I am quite satisfied with our execution in delivering EBITDA and earnings growth, and strong free cash flow generation, while investing in the business to gain 62,000 more wireless subscriber activations this quarter compared to last year. And we also absorbed about $55 million this quarter in higher pension expense and foreign exchange costs So on the EBITDA side, another good quarter, with growth of 1.5%.

Our margins remained stable, and that's very much the direct result of the slower pace of erosion in our high margin residential Wireline business, and continued strong execution in our efficiency programs to reduce overall labour, G&A and discretionary spending.

Our revenue trend has not shown much improvement over the past few quarters, as we continue to face the challenging environment. While we reported overall growth of 1.2% this quarter, that was driven by the inclusion of The Source and 100% of Virgin in our results starting this quarter. The contribution from The Source is in the form of product revenue, so excluding that pick-up, our service revenues were down, just as they were in the second quarter.

Very briefly on capex, we maintained our capital intensity within our full-year guidance range of 15% to 16%, even with increased spending in the quarter to complete the build-out of our wireless HSPA network ahead of schedule, and the ongoing expansion of our fibre to the node and fibre to MDU program.

On earnings, adjusted earnings was up $0.24 per share year-over-year to $0.84 in the third quarter, and this was primarily driving by a reduction in tax expense from the resolution of past tax positions, as well as from higher EBITDA and the accretion from fewer outstanding BCE common shares due to our NCIB program that we completed in May.

Statutory EPS for the quarter increased to $0.72 per share from $0.31 per share last year. In addition to the positive tax adjustments, the year-over-year improvement was supported by lower restructuring costs and gains on divestitures.

Restructuring costs were $0.16 per share this quarter compared to $0.26 in the third quarter of 2008. The higher level of restructuring costs last year was to accrue obligations related to workforce, and real estate downsizing, and the implementation of our 100-day plan.

This quarter, in light of the Supreme Court ruling on September 18th on the use of the deferral account funds, we recorded a $152 million charge, which reflects our current estimate of the remaining amount of our deferral account commitment, and with this charge, our commitment under the deferral account is now fully provided for in our financial statements. I would also like to point out that from a guidance perspective, that will have no impact on EBITDA or adjusted EPS for 2009 since that's being recorded as a restructuring charge.

The gain this quarter was on the sale of about half of our stake in Clearwire and our entire position in TerreStar Canada. Both of those investments obviously are non-core.

And finally, strong free cash flow; even with higher year-over-year capex, pension funding and reduced working capital, we generated a very healthy cash flow of $649 million for the quarter. So overall, I'd say notwithstanding ongoing revenue pressures in our business markets, solid financial results in line with our increased guidance targets for the year, and importantly, achieving a good balance between investing in growth and profitability.

So let's move to the segment results. Wireless service revenues were down slightly year-over-year as voice revenues continued to be a drag on ARPU in the quarter. With the weak economy, the industry as a whole is seeing reduced roaming and reduced out of plan usage, consistent with decreases in employment rates and travel. Much of the voice revenue decline was offset though by significantly higher data usage, driven by increased penetration of smartphones and wireless turbo sticks. We are seeing some stabilization as the year-over-year decline in voice ARPU this quarter was essentially consistent with what we saw in the second quarter. We're also encouraged by the stronger subscriber acquisitions this quarter, which bodes well for future service revenue growth. And with the launch of our HSPA network, I believe there is opportunity to improve on our churn, which we see as being at an unacceptable level today. Wireless product revenues were up 1.9%, reflecting the acquisition of Virgin and The Source. Wireless EBITDA held steady year-over-year, even with significantly higher gross additions, and that underscores our commitment to spending on customer acquisition and retention in a disciplined way. So a good disciplined quarter in wireless with increased investments to take a stronger share of customer adds to enhance our future profitability.

In our Wireline segment, revenues were higher year-over-year by 1% due to the contribution from The Source, which is reported principally in the Equipment and Other Product line. The Bell Residential Services continued to deliver strong financial performance in video and residential internet, and in upselling optional services to local telephone customers. All of that contributed to a robust 9.3% year-over-year increase in average revenue per household. This quarter, the pace of retail residential NAS erosion slowed for an eighth consecutive quarter but the trends that have been affecting our business market unit continued. We are not seeing any indicators of sustained improvement in spending or usage volumes by our business customers, and therefore, we're going to remain cautious on the economy until employment figures begin to show some improvement.

The pullback in business markets led to a higher level of local access line disconnections, a decrease in toll volumes and fewer new installations. Legacy data services and product revenues decreased year-over-year, in line with the reduced level of business activity. Continued solid growth in IP broadband services, however, provided some upside to data revenues this quarter.

Clearly the highlight in the quarter, as George said, was our Wireless segment EBITDA growth of 2.1%. So with moderating service revenues, we continued to focus on reducing the cost base of our operations. Combining Enterprise, SMB and Bell West units into a single business focus unit not only improves our customer focus, but it also optimizes our efficiency. And incidentally, our Wireline margins have been maintained now at around their current level for most of the past five years.

If we quickly compare our results to that of our direct peers, we are definitely starting to see the type of performance in our Wireline business that we're after. Certainly relative to the other major North American telcos, Bell's EBITDA growth, both on a Wireline and a total Company basis, outperformed in the third quarter and it has done so consistently for a number of quarters now. And we're pleased to see that our reported EBITDA, EPS and free cash flow for the quarter are all ahead of the street's consensus. Given that we've achieved this result with less wireless exposure than our peers, there should be an opportunity to continue to improve over the next few years, as we capitalize on market growth from our new HSPA network, and the new wireless distribution presence that The Source will bring, beginning in the first quarter next year.

If we turn to look at profitability, adjusted EPS for the third quarter grew 40% year-over-year to $0.84 per share. The tax recoveries I referred to earlier amounted to $0.29 per share this quarter, or $0.22 higher than last year. Accretion from fewer outstanding BCE shares also provided upside to adjusted EPS this year, and that offset higher year-over-year depreciation, principally relating to satellite and campus launches. With year-to-date adjusted EPS of $1.99 per share, and our expectations for the business in the fourth quarter, we are forecasting adjusted EPS for 2009 to now come in at the higher end of our guidance range of $2.40 to $2.50 per share.

On slide 22, you have the details of our free cash flow generation. Year-over-year capital investment increased $23 million. Cash pension funding increased $41 million, in line with the expectations that we set at the beginning of the year, and working capital declined with a build-up in inventory levels ahead of the fourth quarter. With that, free cash flow available to common shareholders was $649 million for the quarter, bringing our year-to-date free cash flow to a total of $1.441 billion, all of that very much tracking to our guidance, even with an unfavourable year-over-year foreign exchange impact of almost $100 million. So my key message here is that our cash flow remains strong and reliable, with growth opportunities ahead from business performance, continued efficiency gains and a meaningfully strong Canadian dollar.

On our balance sheet and liquidity position, you can see that that's also very healthy. On slide 24, during the quarter we funded the closing of the acquisition of The Source and Virgin, we redeemed early $600 million of Bell M-16 notes that were due in 2010, and we repaid $52 million of capital lease obligations. Free cash flow generation, net of common dividends together with proceeds received from the sale of non-core assets put Bell into a cash balance at the close of the quarter of $1.2 billion. In the fourth quarter, we will be funding a minority investment in the Montreal Canadiens - that's in the amount of approximately $50 million - and we will be repaying on maturity in December of this year, Bell Series EC debentures of $150 million. We also earmarked a further $400 million of cash to meet our remaining debt maturities in 2010. So, consistent with my comments to you on last quarter's results call, we continue to project a surplus cash balance of approximately $500 million going into 2010. Also, as you see on the chart, the Company's key credit ratios are very comfortably within our policy range, and therefore, we continue to maintain a strong credit profile and lots of financial flexibility. Finally, we have a good dividend coverage to support what we believe to be an attractive BCE dividend yield, currently at about 6%.

So to summarize then, I'd say a good quarter in which we balanced growth and profitability, invested smartly, and maintained our margins across the Company during a difficult economic climate.

Looking out into the fourth quarter, we continue to experience some revenue challenges from the weak economy and the slowdown in business market spending, but we do remain very well positioned in each of our markets. We expect to see a modest step-up in our wireless revenue trajectory, driven by the stronger subscriber acquisitions, higher smartphone penetration and the recent launch of HSPA, and with the inclusion of the revenues from The Source, we target to be at the low end of our increased 2009 revenue guidance. Finally, on EBITDA, we intend to continue to implement efficiency and cost saving initiatives, both to maintain margins this year in the face of higher pension costs and economy related pressures, as well as to deliver sustained improvement in the profitability of our business going forward.

As you may know, there was a recent settlement with the government in respect of Part II broadcast license fees for the last three broadcast years ending August 31, 2009. As a result of that development, we will be reflecting the reversal of our accrued obligation relating to that period in our fourth quarter results. This does provide us with some incremental EBITDA headroom that we can use in the fourth quarter to capitalize on the earlier launch of our HSPA network, and to do that without compromising our EBITDA guidance for the year. We also estimate that Part II fee rates going forward will be approximately 30% lower than the current rates, and that should provide us with around $5 million of annual cost savings going forward.

So, in summary, our focus will continue to be on delivering against the five strategic imperatives George has set out for the Company at the beginning of the year and to try to sustain a pick-up in momentum going into 2010.

So to move to your questions, I'll turn it back to Thane and to the Operator.

Thane Fotopoulos

Thanks, Siim. So just before we begin the Q&A session, I'd like to ask the participants to limit themselves to just one question and a brief follow-up so that we can get through as many people in the queue as possible given the time that we have remaining. As always, I am available for any follow-ups and questions after the call that we did not get to. So with that, Operator, if you can please quickly explain the polling instructions, we're ready to proceed.

Q & A

Operator

The first question is from Greg MacDonald from National Bank Financial. Please go ahead.

Greg MacDonald, National Bank Financial

Thanks. Good morning, guys. Question is on the outlook for buybacks and dividends. TELUS lowered guidance this past quarter: the big driver obviously is the subsidy effect of smartphone loads. You did not lower guidance, but nonetheless, I think we can assume, to the extent of success that you have on smartphone loads, it could be pressure on EBITDA in the near-term. With that as the context, I wonder if you just might comment, first, on buyback plans going into 2010 - the benefit, of course, is supportive on EPS so it speaks to earnings risk. And then secondly, on the dividend, George, your previous comments suggest that you'd like to see continued growth in the dividend. Is that still the case? And I'm assuming the double dividend increase this year is an anomaly. If you can confirm that, and just kind of talk in terms of the context of, is that still an annual thing that the Board looks at? Thanks.

George Cope, President and Chief Executive Officer

Thanks for the questions. In terms of the same comment I made at the end of the second quarter, we will address plans of cash on the Company's balance sheet early in the new year when we talk about guidance, and that will happen in either January or February. So we'll clarify use of cash on the balance sheet. We will also clarify dividend intentions at that time for the coming year. It is clear though - I want to make sure it's very clear to the investment community - that our strategy of a dividend growth model is exactly how we plan to focus execution at the organization. So we'll clarify dividend intentions for next year, as I said, early in the New Year. I think that the set expectations are: one, yes, we probably won't have a dividend increase twice a year going forward, but it is also important to understand that last quarter the dividend was increased to be consistent with our dividend payout policy that we provided the investment community last February. We would have been under that payout ratio, and we clearly don't think that would be consistent with the capital markets model that we shared with the investment community.

So we'll clarify our intentions for surplus cash in February and comment on dividends for next year at that point in time.

Operator

Thank you. The next question is from Jonathan Allen from RBC Capital Markets. Please go ahead.

Jonathan Allen, RBC Capital Markets

Thanks very much and good quarter. Question for you, George, on the wireless side; first, actually, a clarification. You had mentioned the AT&T roaming agreement, and I think you had mentioned before that there is still some investor confusion about that. Perhaps you can describe how exactly that works and whether Bell is truly the preferred HSPA partner and not Rogers now?

The bigger question though for you, George, is about wireless ARPU. You had mentioned in the MD&A that there is some customer downgrading on plans. Recently we've seen both Rogers and TELUS making some adjustments to their wireless plans, including removing the subscriber access charge. I'm curious on your thoughts about those pricing changes and whether Bell would follow along, or are you going to try to keep the ARPU higher?

George Cope, President and Chief Executive Officer

Okay, well on the AT&T roaming, we have a relationship now with AT&T. It is really, in one sense, in AT&T's hands as to which network they choose to have their customers roam on. The very encouraging sign is today people who have iPhones who are landing in Toronto are roaming on our network. So the key opportunity for us is that's new revenue for us, and we anticipate with the extensive footprint we have relative to our competitor now, that carriers around the world will choose us as the preferred carrier, and we think AT&T has, not publicly stated anything on preferred carrier, but given we know people now landing in Toronto and Montreal are on our network, that might be indicative of what decision they may have made, so quite positive we think, for us.

In terms of ARPU, we did comment on the economic issues, competitive issues and obviously, we are aware of some pricing change that we've seen recently in the market, and we will remain competitive in the marketplace with those pricing changes. I'm not going to announce pricing here on the phone. We do it on a daily basis in the marketplace, but we'll make sure we remain competitive.

Jonathan Allen, RBC Capital Markets

Do the problems that Globalive has been having on the regulatory front change your views on pricing now?

George Cope, President and Chief Executive Officer

We think there is new competition coming to Canada from Videotron, from other qualified Canadian telecom carriers who have publicly announced that they'll be in the marketplace, so we are fully preparing for new competition in the wireless market in Canada, and we think Globalive is only one of those new entrants that were going to enter the market, and I think it's important for the investment community to be clear on that as well, that there still is new competition coming and that's what we're preparing for.

Operator

Thank you. The next question is from Simon Flannery from Morgan Stanley. Please go ahead.

Simon Flannery, Morgan Stanley

Okay, thanks very much. Good morning. Could you give us a bit more detail on the smartphone mix, some sense of what the percent of the base that has smartphones now, and in percent of adds that are smartphones? And any comments you can make, George, I know it's only a week or so, but how the launch is tracking on the HSPA network? Thanks.

George Cope, President and Chief Executive Officer

Sure. I mean the data device - the subscribers we mentioned are up 124% year-over-year. We're carrying roughly 20 smartphones now in our portfolio, and clearly knowing that the ARPU that we generate from the customer is more positive as we move clients to smartphones—that is our direction from a sales and distribution standpoint—I don't know that I'd shared the exact mix here, but you can see with the data growth that we had in the quarter, moving in the right direction at 33%. We need to do even better than that, and we look to do that with the HSPA launch.

It's really too early to make any comments on the launch. I think the most encouraging thing for us is that we were able to get the market for the fourth quarter, and we were able to do it with HSPA+ in most of the markets, and that of course, for us, is really important on the smartphone side, not just the wireless stick where people on the laptops will be using the high speed, but also on the actual smartphone where the speed at which you access information generally will be quicker than our major competitor.

Operator

Thank you. The next question is from Glen Campbell from Bank of America - Merrill Lynch. Please go ahead.

Glen Campbell, Bank of America - Merrill Lynch

Yes, thanks very much. The performance on the cost side is just terrific this quarter once again and, George, I wonder if you could talk about how this looks going forward? I guess the skeptics would say you hit a point of diminishing return: as the economy picks up, you'll have more lower margin revenues, so it's hard to take costs down at the same rate as we've seen recently. But as you look out the next few years, could you talk about whether you are seeing diminishing returns or do you expect, other than the cyclical effects we've just seen, you know, a fairly steady cost reduction path, and maybe a bit about what kinds of areas you see that in? Thanks.

George Cope, President and Chief Executive Officer

Yeah, I think our imperative of achieving a competitive cost structure cannot go away in our particular industry in the segments that we compete in. So it's going to continue to be a core competency in the organization and so that focus continues, and that goes across, as we've talked about, it's not just in the area of labour, it also goes to our other costs that we're spending on, amount of advertising dollars we're spending, number of agencies we use. Talked before about management of outside resources being down dramatically. I mean it's as granular as making sure when our vehicles are on the road that they're not running on idle, and therefore, going through fuel. Adding location-based service to the vehicles to be more productive. There's a list on the vendors side on where we do outsourcing; on the billing side where there are new contracts coming due where there are significant opportunities for us there. It frankly is a bit of a never-ending focus of the organization, and I think our ability to continue to drive that is going to be core to what we're going to have to do. And I think particularly the business side of telecom is clearly being impacted by the economy. I am fully confident that at a point in time, as the economy begins to turn, that part where we're under pressure will relieve itself, and give us a little bit of momentum, so that it's not clearly just a complete cost restructuring that we're always going through.

Now the other side of that is our capital intensity management. We'll continue to be in the 15% to 16% as we've guided the street through 2009. You can rest assured it'll be that way in 2010 as well.

Glen Campbell, Bank of America Merrill Lynch

Just to follow-up then, when you talk about monitoring vehicle idling and that sort of thing, it speaks to great execution, but it also means that, you know, it also would make us worry that you're really near the end of the big potential reductions. I mean is that wrong view? I mean are there sort of step function reductions you can see? I mean more eCare, dealing with customers online, that kind of thing, the network, etc.?

George Cope, President and Chief Executive Officer

Exactly. We started a program at Bell Mobility which customers have been very receptive to - about six months ago - where all of our postpaid new clients now go on eBill, and the customer, if they want paper, it's $2/month. And our customers are generally choosing to have eBill and if those prefer from an environmental standpoint to still have the paper bill, then we are prepared to do that but there's a $2 charge for that. And we've had no market pushback because there's a general view by the consumer that it's the right thing to do from an environmental standpoint, and most people prefer it online today anyway.

We have not, to date, taken that to other areas of the business on the consumer side - some of our Wireline portfolio - those are things that we can still look at, and also, over time, our billing costs will drop in Wireless if over the next two to three years all of our clients move to eBill, that's another significant savings. So those are the type of things that we're working on still. I'm never going to say that it ever gets easier. It always gets tougher and I think the investment community is right to ask those questions.

Siim Vanaselja, Chief Financial Officer

I'd just add to George's remarks that we certainly do see opportunities for further efficiency gains in areas like Client Care, where we would hope to see reductions in call volumes as we become better in our call centre operations. Field service productivity is moving up, and there's an opportunity to improve central office workforce utilization, and in the area of IT, we would expect, with some of the major projects behind us, to be incurring less costs there, and we would see an opportunity on some of our hardware and software licensing agreements to improve our buying power there. So I do believe that those items and billing, as well as the items that George referenced, give us some good headroom to go after cost reductions in future years.

George Cope, President and Chief Executive Officer

That's a great point. We're getting there, but in our overall IT operating costs, we are not best-in-class. We know what best-in-class is, and we have a target to be best-in-class within the next 24 months. We moved a long way there the last 18 months, but it's going to be another 24 months before our cost structure in IT is what we would call best-in-class.

Operator

Thank you. The next question is from Jeff Fan from Scotia Capital. Please go ahead.

Jeff Fan, Scotia Capital

Thanks very much and good morning. My question is on the handset subsidy related to the new HSPA network, and I guess, more specifically, iPhones. You introduced some iPhone plans which looks like it attracts a broader segment out there, with more choices and more options with the pricing that they're coming in on the monthly plans. As you look forward - and not just this quarter or even next year - if the iPhone subscribers coming in are not giving you guys the same ARPU that perhaps Rogers has been getting over the last year and a half, wondering if there is any flexibility there to adjust the subsidy in order to continue to maintain that lifetime value or lifetime profitability on that subscriber going forward?

George Cope, President and Chief Executive Officer

First of all, it's early to talk about how we would change what we're doing because, you know, we've really just begun on the HSPA side, as you know. I think handset subsidies on smartphones remind me very much of handset subsidies on digital phones in 1995, and there's no debate from anyone today that the net present value of that investment in those subsidies in 1995 turned out to be very accretive for shareholders, and so I have no doubt that they will here. There is no doubt that our cost of acquisition goes up with some of these devices, but Siim made a very important point that if you look at our gross adds in this quarter, and then you look at our churn number, we've actually closed the gap significantly on the gross side, and we still have work to do on the postpaid churn side, and we believe that is one of the biggest competitive elements of our new HSPA network, where customers who would have been attracted to certain smartphones that we weren't able to carry, we now can meet the demands of our current customer base. And we look forward to, by meeting that demand of our current customer base over time, would like to see our churn on postpaid get back to levels we've seen historically, and be at the levels that our competitor, one of our competitors is enjoying today, and that I think is one of the benefits that if we drive that down, we can justify the retention and the COA costs. And, obviously, all of our guidance next year will take into account the type of cost structures that everyone knows are there on those handsets, and at the same time though, we also know that our commitment to the investment community is to maintain a dividend growth model, and that is how we're going to drive our costs out to make sure we're able to do that.

Operator

Thank you. The next question is from Bob Bek from CIBC World Markets. Please go ahead.

Bob Bek, CIBC World Markets

Thanks. Good morning. Just a bit on the Wireline side. Obviously you're seeing some good stabilization on residential line losses. You have a package with Solo, and I think Fido is out there with some big bucket zone-based packages. Are you starting to see any sort of change in dynamic as far as wireless substitution goes with what you're seeing within Solo? And just any comments you have as far as the line loss prospects given your thoughts on substitution and your pricing on Solo? Thanks.

George Cope, President and Chief Executive Officer

We've seen no acceleration in wireless substitution, and we all obviously expect it to continue in terms of wireless substitution, particularly as you mentioned, larger bucket rate plans in the flanker brand part of the market. I think it's important to remember today that, in Canada, literally every consumer has unlimited evening and weekend calling today on their wireless device, and have for the last three to four years, and so that's already reflected in the NAS erosion that we're seeing. And so we always, every year, expect a little increase in the wireless substitution in our Wireline forecasting, and that'll I think continue to be the case going forward. And we are obviously very cautious, that if you see acceleration in even larger bucket plans, that those are things we have to make sure we're managing our cost side in anticipation of possibly that those NAS issues that we might have.

The other side of that is the differentiation by launching the 100 HD channels, to try to have a bundle with the investment in fibre to the node, so that those other two products help, if you will, hold for us some of the stickiness on the NAS side on a bundled perspective. But it's work every single quarter and every month, as the investing community knows, and that portfolio that we have clearly is the most challenging.

Bob Bek, CIBC World Markets

Okay. Thank you. Just on that point, can you talk to us what the average node size is for your system or is that something that you've talked about in the past?

George Cope, President and Chief Executive Officer

We'll come back to you on that. We've not in the past, but after the call, Thane's happy to give you a call.

Operator

Thank you. The next question is from Vince Valentini from TD Newcrest. Please go ahead.

Vince Valentini, TD Newcrest

Yeah, thanks very much. Hopefully, I can slip in a clarification and a question. The clarification is, do you count TELUS TV subs as part of your video subs? And the question is probably more for George. Can you level set our expectations for wireless margins for the next few quarters? You did a great job keeping margins up, even with the higher gross adds and the weakness in ARPU in the third quarter, and you're talking about cost discipline, being able to offset the HSPA devices, but should we really expect margins to be able to hold up during the first wave of iPhone and HSPA device sales in the next three or four quarters?

George Cope, President and Chief Executive Officer

The first one is, we include—and we'll never disclose, because that's TELUS' work, not ours and we would never do that—TELUS' numbers are in our total sub number. They're not in our ARPU at all, so you have our retail ARPU, and you have them in our subscriber numbers. And as we've said on slide 14, TELUS has begun to gain traction. We're happy with that relationship and I'm hoping they are as well. I think in the future, for us, it will help us amortize the cost of our satellite, and I'm assuming from their perspective, help them do what we're doing within our portfolio, which is to help our NAS number.

The other question was on wireless EBITDA margins. I think, you know, part of the answer is going to be our total cost structure, Vince, across all of Bell Canada has to continue to be reduced in order for us to have the ability to, as you've described, pay for the higher subsidy that we're going to have on the smartphones. So it's not just our wireless EBITDA margin that has to, if you will, invest in this opportunity; it's all of Bell Canada's costs that have to invest in this opportunity, so that's part of the answer. I'm not going to give a margin guidance here for next year on the call. Clearly, our business plan involves a higher COA next year, and so, the type of pressure that Wade's got on his organization, and what he's trying to do is how does he take costs out? And I think the best example I'd give to investors today is our new postpaid clients are going eBill and have now for almost six to eight months, and that's saving us the money we're talking about on a per bill basis, or they're paying for that in the cost, and as I said, we've had no consumer pushback given the environmental part of this where people realize they can do it online.

So, you know, when we talk early next year, I think our guidance will start to indicate, how we think that will impact the Company, and obviously we have to, as Glen said earlier on, find ways to continue to focus on the cost side to offset this.

Operator

Thank you. The next question is from Peter Rhamey from BMO Capital Markets. Please go ahead.

Peter Rhamey, BMO Capital Markets

Hi. Great. One clarification as well and then something on capex. Siim, you mentioned that you're taking a Part II fee benefit in Q4. Can you remind us what that is and is it a direct offset for the start-up costs on the HSPA? And then on the capex budget, I was wondering if perhaps Siim or George could break down how to think about the demand drivers on capex? We're in a recession here, you know. Could you break down your capex budget between maybe strategic initiatives - such as the broadband initiative - demand-driven capex and maybe maintenance? Thank you.

George Cope, President and Chief Executive Officer

I'll answer that second one and then Siim will come back and answer the first one on the Part II.

In terms of our capital investment, the way, Peter, I would describe it—and we're happy to talk next year to give a little more colour on that than on today's call—but the investment community should rest assured the majority of our capital is going to our HSPA and our FTTN broadband investments. I mean that's where our capital dollars are going. Clearly when the economy slows, we see some demands go down on the network, but we're not seeing that on the broadband side at all. I mean the usage on the Internet—let's just say it's up anywhere from 60% to 80% this year year-over-year. So a lot of our capital dollars are going to capacity to meet the demands of the customer side. So having said that, I think the benefit for us next year is we don't have an HSPA network to build out. We also don't have fibre to build out to every cell site. So, that gives us the headroom to look for other investment opportunities for us and still maintain, as we've said, where we've been this year in that, you know, 15% to 16% capital intensity number, and so we'll talk about how we're going to spend that capital next year, early in the New Year when we talk about next year's guidance.

And over to you, Siim.

Siim Vanaselja, Chief Financial Officer

Peter, with respect to the Part II fees, the amount that we will be expecting to reverse in respect of prior periods for Part II fees is approximately $40 million, and we'll take that into our earnings in the fourth quarter.

Peter Rhamey, BMO Capital Markets

And that's a direct offset to the HSPA?

George Cope, President and Chief Executive Officer

We'll actually probably use some of that to make sure we're investing in the marketplace appropriately on the wireless side, and at the same time, to ensure that we maintain on track with our EBITDA guidance.

Operator

Thank you. The next question is from Peter MacDonald from GMP Securities. Please go ahead.

Peter MacDonald, GMP Securities

Thanks. Just a question again on wireless margins. They're up year-over-year but when I look at them on a sequential basis, they're down after a very good improvement in Q2. Can you talk a little bit about what changed there? And then, as well, can you talk about your plans and how you plan to manage your subscriber migrations, or what Rogers called ups? And I'm looking for that on two fronts really: from the iPhone you're going to have a lot of internal demands, do you plan on restricting those migrations or promoting them, as you talked about the improvements in churn that come from that? And then as well on your network, with the new network you're going out and telling everybody this is a great network. How do you manage the risk that your existing customers all want to migrate over to the HSPA as well, and how do you manage the costs associated with that? Thanks.

George Cope, President and Chief Executive Officer

I'm going to try to answer the migration question and the margin question. The margin question would be that our gross adds were up 60,000 year-over-year, and obviously up over last quarter, and I'll let the investment community decide, not us, but we think maintaining our EBITDA margin at 45% when ARPU was down 4% and gross adds were up 60,000, is indicative of some really, really tight cost management on other expenses. So we're actually pleased with the margin, and obviously we'd like to not see the ARPU declines in the industry, but they are what they are at the moment.

In terms of upgrading, our view on the upgrading is we'd rather have them upgrade an iPhone to Bell than have them leave us and upgrade to the competitor, which was what was going on in some of our churn. So first of all, that's a lot more accretive than having them go somewhere else, and so that's how we're going to approach it. Secondly, as you know, we have customers who enter into postpaid contracts on a subsidy model basis and over the course of 24 to 36 months, every customer generally, in Canada, upgrades their handset. So we would anticipate over the next 24 to 36 months, literally all of our postpaid base will have upgraded their handsets to the HSPA network, and so that's in our cost structure. And we'll see some early acceleration of that, for sure, and that's where we've got to be, as everyone knows, pretty prudent on our management there. But we clearly want our customers on the high-end ARPU side of the segment to upgrade to Bell, and not see them - what we've seen over the last year and a half - have some of those customers leave us and go to our competitor. And, you know, the great news is we've already begun to see that, as I said, on the sales side in the third quarter, and we'll look for the fourth quarter as we begin to execute, to hopefully see the fourth quarter next year some improvement in that churn area. So, we're really, really excited about the three strategic pillars we put in place for wireless, which was clearly, the network driving the opportunity - the new network - dealing with the flanker brand issues with Virgin, and then dealing with our distribution disadvantage, which frankly, we've not been able to take advantage of yet, The Source, but we will in the first quarter.

Peter MacDonald, GMP Securities

And do you plan to wait for the term contracts to expire or are you going to be aggressive.

George Cope, President and Chief Executive Officer

Well it's kind of customer-by-customer, to be honest. And I don't want to give away competitive tactics here on the call.

Operator

Thank you. The next question is from Dvai Ghose from Genuity Capital Markets. Please go ahead.

Dvai Ghose, Genuity Capital Markets

Thanks very much. Good morning. Given the success that AT&T is having now with U-verse, and the fact that TELUS TV, on the IPTV side, seems to be rolling along, is the time right now for IPTV? You've said in the past that you're going to wait until the time is right. And seeing as it's in vogue, a quick clarification question for Siim, if I may. Why do you include non-recurring tax gains in your recurring EPS, and you don't include recurring restructuring charges? Just a little confused about that.

George Cope, President and Chief Executive Officer

First part of the question, Dvai?

Dvai Ghose, Genuity Capital Markets

Yeah, IPTV. Given the fact that there's been quite a lot of movement this year, not just in North America but globally, are you more comfortable in, you know, looking at IPTV with a launch in mind?

George Cope, President and Chief Executive Officer

The evidence that we're seeing on IPTV from AT&T in the US continues to be more and more encouraging. Our investment in fibre to the node positions us to be able to deliver IPTV when we think it's appropriate in the market to do. I think the experience that we're seeing TELUS have is encouraging for us as well, and so, how we direct our capital in 2010, we will certainly take into account those developments of both those companies you've talked about, and ultimately for us, it's a bit of a hand in glove. The ability to have IPTV to add to our TV momentum on the satellite side is a formula we think is set for success. We just have to see the model work for us, and I'll talk more about that as we get into next year. But obviously we'll never clarify completely when and if we would be to market because really the ones most interested in that are our competitors, whereas what our investors, of course, would want to know is that we're going to be able to do that and stay within our capex number of 15% to 16% and that answer to that is, we could and so we would.

Dvai Ghose, Genuity Capital Markets

And, Siim, just along the clarification, because I'm just a little confused as to why these big tax reversals are in your recurring EPS number when restructuring charges aren't.

Siim Vanaselja, Chief Financial Officer

Right. Well, Dvai, you know, I'd say the main thing is that there needs to be transparency in the reporting of these numbers, and there isn't necessarily consistency from company-to-company even in the reporting of these numbers. Some of our competitors, for example, would normalize for EBITDA for year-over-year pension changes in their EBITDA. We record non-recurring tax gains on the basis that our expectation is that they're going to be in our results each year on a recurring basis, and it's our practice to file tax returns with the authorities with uncertain tax positions in them. It's a number of years before those uncertain tax positions ultimately get resolved. We usually provide for that in our accounts on a conservative basis, and therefore, as those items get resolved with the tax authorities, we bring them back into income.

Restructuring costs are a little bit different in our view in that they're more one-time. Now we have seen, for the past few years, a regularity in downsizings across the Company, however, we would expect as we move forward for those restructuring costs to come down significantly.

George Cope, President and Chief Executive Officer

Yeah, and Dvai, the only thing I would also add - for the investing community so there's no lack of clarity, - if someone were to look at Siim's slide on page 22, we clearly normalize for some of the difference in how people treat restructuring in their EBITDA, any way you look at it, we think we're performing well relative to our competitors.

Dvai Ghose, Genuity Capital Markets

Yeah, that's a fair point. No, I saw that. Thank you.

Operator

Thank you. That concludes the question and answer session. I would like to return the meeting to Mr. Fotopoulos.

Thane Fotopoulos

Thank you, Wayne. So for those of you who didn't get your questions answered, and for any follow-up, feel free to call me. I'm available for you. So on that, thank you very much.
