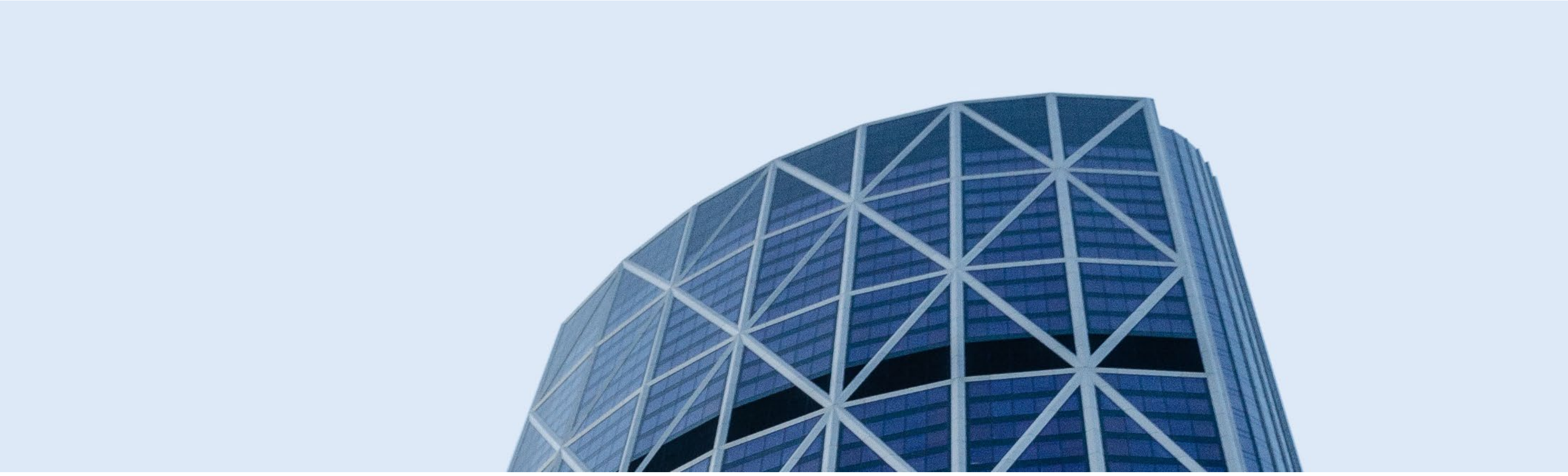
BCE cuts its dividend

May 8, 2025

Craig Jerusalim, Senior Portfolio Manager
Greg Zdzienicki, Client Portfolio Manager
Mickey Ganguly, Senior Equity Analyst



What happened?

BCE announced a much-needed dividend cut this morning, slashing their annual dividend by 56%, to $1.75/share from $3.99/share. This dividend cut is a necessary step to defend a challenged balance sheet with a high leverage ratio and a previously unsustainable payout ratio of greater than 100%. With the announced dividend cut, BCE gains flexibility on their capital allocation plans and protects the balance sheet as they continue to face a challenging competitive environment while also expanding in the US. While the dividend cut was a necessary and welcome step, we continue to see operational challenges ahead for BCE as the industry adapts to a four-player market and uncertain macroeconomic environment.

With high dividend payouts, challenging free cash flow profile, increasing capital expenses, and expansion ambitions, we believe the only viable option for BCE was to cut the dividend. While the industry has been challenged in recent years, we don't see elevated risks of other telecommunications companies following in BCE's footsteps. The other companies in the space either have a payout ratio below 100% or are experiencing growth.

Historical context

BCE has had a strong track record of maintaining and growing their dividend even in situations where they were investing heavily in their business. This continued even when BCE started their fibre deployment strategy, which is extremely capital intensive. Over the last five years, we saw BCE further accelerate their fibre deployment due to increasing demand for connectivity. There was a good business case to invest in the business to grow their fibre footprint even though their payout ratio remained above 100%.

The decision to build fibre capacity was made in 2020 when interest rates were low. However, by 2022 interest rates were significantly higher. BCE continued to invest in their fibre strategy, weighing on their ability to generate enough free cash flow to cover their dividend payments. This put additional pressure on their balance sheet, compelling the company to continue borrowing, and hold off on paying down their debt, driving interest expense higher year after year.

In 2023, with Quebecor's purchase of Freedom, we saw further competitive pressure on the wireless industry as a competent fourth player disrupted a three-player market. Wireless is a highly profitable segment of the business, and the disruption has weighed on the entire sector for over 2 years now. BCE and the industry fared reasonably well in 2023 and 2024 despite a new entrant as immigration remained at historically highs, driving high volume growth in the industry. However, the announced immigration curbs last year have pressured volumes for the industry. While the industry could absorb the pricing pressure from a fourth entrant, the addition of lower volume has weighed on growth across the sector. Pairing declining volumes with BCE's challenged balance sheet and free cash flow profile further deteriorated BCE's financials.

The latest issue of concern came when BCE announced their intention to expand into the US through their purchase of Ziply, an internet provider with a focus on fibre operating in the Pacific Northwest. While the purchase of Ziply was mostly leverage neutral, as BCE funded this with the sale of Maple Leaf Sports & Entertainment (MLSE), we grew concerned about the funding requirements for the business as it expanded into a wider territory. We believe BCE shared those concerns, as in conjunction with the Ziply acquisition announcement they also paused their dividend growth program which they had maintained for several years. Even with the dividend cut announced today, concerns around fibre expansion remain as the US is a highly competitive market.

Outlook

We were fully expecting this dividend cut. This cut begins to change the narrative away from a company with an over levered balance sheet and a high payout ratio to one focused on fibre growth and free-cash-flow generation.

BCE didn't take half measures; they cut the dividend substantially, which builds confidence that no additional cuts are coming. They also removed their dilutive premium dividend reinvestment plan. Additionally, the joint venture that they announced with Public Sector Pension Investment Board on their Ziply fibre buildout also helps to de-lever and contribute to incremental growth.

Within some of our strategies, we have not owned any BCE prior to the last few weeks. We initiated an under-weight position in BCE in our dividend growth funds in anticipation of these changes, and will be looking for opportunistic prices to add more to benefit from a normalization in BCE's relative valuation given the high-grading of their quality attributes consistent with our quality GARP (growth at a reasonable price) process.

While BCE is not all of a sudden becoming a growth company, their US growth strategy is one that typifies short term pain for long term gain. Unfortunately, the Canadian telecom back-drop remains highly competitive, which is contributing to deteriorating industry profitability. Currently, BCE trades at 10.8x earnings (compared to a 10-year average of 16.6x) and 6.8x EV / EBITDA (compared to a 10-year average of 8.3x). As a result, we remain underweight the collective sector, even though there may be tactical opportunities at times that we will look to take advantage of.

Forward-looking statements include statements that are predictive in nature, that depend upon or refer to future events or conditions, or that include words such as "expects", "anticipates", "intends", "plans", "believes", "estimates", or other similar wording. In addition, any statements that may be made concerning future performance, strategies, or prospects and possible future actions taken by the fund, are also forward-looking statements. Forward-looking statements are not guarantees of future performance. These statements involve known and unknown risks, uncertainties, and other factors that may cause the actual results and achievements of the fund to differ materially from those expressed or implied by such statements. Such factors include, but are not limited to: general economic, market, and business conditions; fluctuations in securities prices, interest rates, and foreign currency exchange rates; changes in government regulations; and catastrophic events. The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. CIBC Asset Management Inc. does not undertake, and specifically disclaims, any obligation to update or revise any forward-looking statements, whether as a result of new information, future developments, or otherwise prior to the release of the next management report of fund performance.

The views expressed in this material are the views of CIBC Asset Management Inc., as of May 2025 unless otherwise indicated, and are subject to change at any time. CIBC Asset Management Inc. does not undertake any obligation or responsibility to update such opinions. This material is provided for general informational purposes only and does not constitute financial, investment, tax, legal or accounting advice, it should not be relied upon in that regard or be considered predictive of any future market performance, nor does it constitute an offer or solicitation to buy or sell any securities referred to. Individual circumstances and current events are critical to sound investment planning; anyone wishing to act on this material should consult with their advisor. The material and/or its contents may not be reproduced without the express written consent of CIBC Asset Management Inc. Past performance may not be repeated and is not indicative of future results.