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Buy-outs in Canada

DIY

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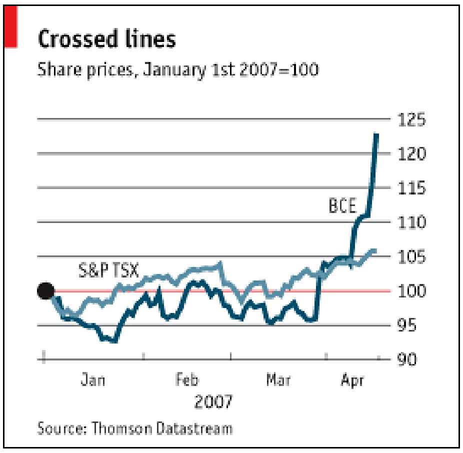
Pension funds circle a national treasure

NO ONE was terribly surprised this week when Bell Canada Enterprises, owner of the largest telephone company in Canada, with a market value of C$31 billion ($27.5 billion), looked as if it was about to become the target of competing takeover bids. Its share price had languished for months (see chart) and managers had failed to come up with much of a plan for the business.

What has raised eyebrows, however, is the nature of the likely bidders. BCE's pursuers come from the ranks of the largest public pension funds in Canada, all seemingly intent on taking a direct stake in the telecoms company and relegating private-equity firms to the role of junior partner.



On one side is the Ontario Teachers' Pension Plan, which invests C$106 billion on behalf of 271,000 active and retired teachers. It is thought to be allied with Providence Equity Partners, a Rhode Island firm specialising in communications buy-outs. On the other, the Canada Pension Plan Investment Board, with assets of C$110.8 billion, the Caisse de dépôt et placement du Quebec, with C$143.5 billion under management, and the Public Sector Pension Investment Board, with C$35 billion. Helping them out is Kohlberg Kravis Roberts, a private-equity firm that is, unusually, taking a backseat role.

Although private-equity investment by pension funds is not new, their preferred route has been to use the services of a buy-out firm, even though that means paying high fees. Not with BCE, however. “They are cutting out the middleman,” says Keith Ambachtsheer, a Toronto-based pensions specialist and author of the book, “Pension Revolution”.

Ontario Teachers' Pension Plan, the most active investor among Canada's pension funds, has been dabbling in private equity since 1991. Privately held shares and capital investments in infrastructure and timber holdings make up about 12% of the plan's portfolio. “The large Canadian pension funds are somewhat unique in that they do a lot of their investing with internal staff,” says the fund's Robert Bertram. His group does about half its private investments in-house and in those deals it saves the annual fee of 7% that it says it typically pays private-equity firms. That is a big saving given an average return on private capital of about 25%. Ontario Teachers' resorts to an outside firm when it feels it lacks expertise or financial clout.

Pension funds in other countries have not developed a taste for direct acquisitions as readily as have Canada's. Partly that is because other countries' institutions may have mandates that stop such activity, says Kirk Falconer of Thomson Financial, a data provider. Some funds in the Netherlands and Britain have taken a similar approach, but they are rare.

Along with their do-it-yourself spirit, Canada's pension plans are bulking up on infrastructure assets worldwide, both directly and through private-equity intermediaries. Ontario Teachers' is buying the New York Container Terminal from Orient Overseas, a transport firm. Last year, it was part of an unsuccessful bid to buy BAA, a British airport operator. The Canada Pension Plan Investment Board, meanwhile, is part of the consortium that owns AWG, parent company of Anglian Water in Britain. It also has interests in a gas-distribution company in Wales and an electrical-transmission company in Chile. Infrastructure appeals to pension plans because it has offered stable returns over long periods and can sustain high debts.

Much of the infrastructure investment has taken place outside Canada, says Mr Bertram, because governments in places like Britain and Australia have got the regulatory mix right, whereas the government of Canada has not. The takeover of BCE may be different. It would be one of the largest—and possibly the most controversial—in Canadian history both because American buy-out firms are in action and also because the “widows and orphans” stock is one of the most widely held in Canada.

Yet if anyone can force through a deal, it is the pension funds, which represent almost all the workers in Canada. That should dampen fears, common in the country, that a national asset is about to pass into foreign hands. Whether Canadians would welcome the passing of a big publicly held company into private hands is another matter. Mr Ambachtsheer says the swing back to more concentrated control tends to leave companies in the hands of motivated owners who can keep a closer watch on managers. To look at it another way, the workers may finally be in charge of the business.