


 **The CanWest  
dream didn't die  
in October when  
the company  
entered creditor  
protection.**

**No, it died long before that**

by Grant Robertson

**28/01/2008, to be exact**





On a deep winter morning last year, Leonard Asper summoned a dozen or so Bay Street analysts and investors to Toronto's stately King Edward Hotel for a private lunch. The city was knee-deep in snow, but inside the hotel's Kensington Room, grilled shrimp and white wine were in the offing, and the talk was of warmer climes—Australia.

The chief executive officer of CanWest Global Communications Corp. had become impatient with his company's eroding share price. In less than a year, stock in Canada's largest media company, owner of the Global Television network, 13 daily newspapers and more than 20 cable channels, had fallen to less than \$6. Asper was starting to take the slide personally. With good reason: The drop from nearly \$12 the previous January had halved the value of the family's controlling stake in the company.

To Asper, the problem was all just a simple misunderstanding stemming from CanWest's decision to cancel the sale of its Australian TV network a few months earlier. It was a flip-flop in strategy, sure, since investors had been told to expect a deal, which would help pay down the company's debt. But to Asper, the market was wildly overreacting.

Now, with a captive audience of some of the most influential CanWest-watchers, an upbeat Asper set about convincing them that CanWest's 57% stake in Australia's Ten network was too important to sell. Flanked by high-level executives flown in from Sydney for the occasion, the CEO had the lights dimmed as he launched into a narrated slide show carefully orchestrated to change Bay Street's mind. "It's got a lot of growth opportunities..." Asper began.

The pitch didn't work.

To everyone but Leonard Asper that day, the problem at CanWest wasn't one of perception. The problem wasn't even Australia itself. Rather, it was the same four-letter word that has tripped up countless overreaching executives over time: debt.

When Asper was handed the reins to CanWest in 1999 by his father, Izzy, he inherited a business that was built using debt as an instrument. Izzy, a street-smart tax lawyer, started CanWest by purchasing a small TV station in North Dakota, then trucking the broadcasting equipment north to Winnipeg. Over the next three decades, the business grew across Canada and overseas. The younger Asper shared his father's vision, it was well known, and he vowed to expand the empire. But did the son have his father's touch?

As he stood at the front of the room enthusing about the Australian TV market, Leonard Asper didn't realize that his most important audience—Bay Street—had already tuned him out. Everyone but Asper could see: Yes, Australia was a nice, profitable asset. But that was precisely why it needed to be sold. If CanWest didn't start paying down its \$3.8-billion debt, the company was going to crash.

Two hours after it began, the meeting concluded and the analysts filed out. A few gathered in small

groups in the lobby to discuss what they had just witnessed. CanWest was *not* selling Australia. It was *not* paying down debt. One analyst, whose firm was once a major investor in the company, shook his head. "They're fucked," he said.

January 28, 2008, was the day Leonard Asper lost Bay Street.

**B**lame for the problems that forced Can-

West into creditor protection in October is typically laid at the feet of Izzy Asper. The patriarch's single-minded drive to create a national media powerhouse led to the purchase of Hollinger Inc.'s newspapers from Conrad Black in 2000. The debt from the peak-of-the-market price—\$3.5 billion—outlived Izzy, who died in 2003. Defenders of Leonard Asper ask what the now 45-year-old son possibly could have done to avoid his company's fall.

Quite a lot, actually. What is almost always overlooked in CanWest post-mortems is that Asper missed three critical chances to save his company over a three-year period.

The first opportunity came in the summer of 2005. The markets were strong and the notion of a recession in the near future seemed absurd. What's more, corporate Canada was pulsing with income-trust fever. Any asset that reliably generated cash, but was not in the sort of high-growth position that required prodigious investment, became a candidate for conversion to a trust. Since trusts, by definition, did not pay income tax, but instead paid most of their earnings directly to investors, companies were rewarded with inflated valuations for converting themselves.

Eager to take part in the gold rush, CanWest turned to its newspaper division, which included a dozen English-language dailies across the country, including the *Ottawa Citizen*, Montreal's *The Gazette*, the *Calgary Herald* and *The Vancouver Sun*, each of them dominant in its market. The division was a perfect candidate for conversion. Though the papers were seeing readership declines typical of the sector, they were spinning off steady cash and not likely to require major infusions of capital. Even better, the papers could be neatly parcelled off into an initial public offering without disrupting CanWest's structure.

CanWest went public with plans to sell roughly a

quarter of its newspaper business in the trust market that fall, hoping to raise more than \$700 million. Though Asper and the board had been discussing a trust IPO for more than a year, they dithered. That September, the federal government, which had been nervously watching its corporate tax revenue drain away, announced it was reviewing the sector. By the time the IPO was ready, the CanWest trust was one of a deluge of offerings being rushed out the door amid uncertainty over the future of the trust market.

With investors spooked, CanWest was forced to scale back its trust offering to \$550 million worth of units. CanWest also had to sweeten its annual payouts, boosting distributions from a budgeted range of 80 to 85 cents per unit to 92.5 cents. Together, those changes cost the company \$300 million—money that could have gone toward slaying the debt.

That CanWest had waited too long and missed out on the frothy trust market suggested a basic lack of shrewdness. And if the company was willing to sell a quarter of the newspaper business, why didn't it go large and sell 49%? Asper could have still retained control but maximized his company's advantage on the bottom line, netting \$1 billion.



CanWest founder Izzy Asper and his children—David, Gail and Leonard—in the 1990s. The next generation never paid down the debt that their father incurred

The next misstep was even more baffling. In October, 2006, the federal government announced it was ending trusts' tax advantage by 2011. All trusts would eventually have to convert to public companies and pay income taxes. In response, in May, 2007, CanWest decided to buy back the trust units. Though unit prices had fallen sharply across the income trust sector, CanWest offered an attractive \$9 for each outstanding unit, at a cost of \$495 million.

The rationale was that CanWest would be repatriating the cash payouts, rather than doling them out to investors. But this benefit, which at best was worth \$50 million a year to the company, did not impress analysts. CanWest had just spent close to half a billion dollars to buy back the trust—the windfall that had been realized from the trust offering was all but wiped out for what amounted to a marginal gain. Meanwhile, the debt had edged higher that year.

"With the right moves, the debt was manageable,"

says Chris Diceman, senior vice-president of bond rater DBRS Ltd., which has tracked CanWest's debt closely over the years. "They could have not done the trust buyback."

**I**f the trust two-step represented two missed opportunities to fix the CanWest debt problem, the third—and most important—oversight came a few months later, in the summer of 2007.

The Australian government was relaxing its rules on media ownership, allowing more foreign investment while also opening the door for large media companies to own more assets. The upshot: There would be more buyers in the market and the value of Australian media companies would surge.

Asper had seen the regulatory signals for a while, and he began discussing a sale of the Ten network with analysts. This was not an easy decision, since Ten was one of his father's crowning achievements, a veritable gusher of a find. Izzy Asper acquired an initial stake in the slumping network for a mere \$45 million in 1992, then set about growing the business to be worth 20 times that. Moreover, Ten brought in more than \$60 million a year in cash for its Canadian parent. "People questioned the wisdom of a regional broadcaster in Canada making an initial investment of \$45 million in a struggling third-place television network," Leonard Asper proudly pointed out in a letter to shareholders in early 2007. Izzy had been such a genius, in fact, that the only way for his son to sell the asset without losing face was to get exactly what he figured Ten was worth. Some estimates that summer were pegging the potential price for CanWest's stake at more than \$1.2 billion.

But Asper never got his deal. Bankers were hired to shop the Ten stake, but an offer never came. Word rippled through the Australian market that the Canadian owners wanted too much. Ten was a nice money-spinner, true, but it wasn't dominant in its market; indeed, it was an also-ran in the race for ratings.

By the summer, Ten had spent several months on the auction block; then Asper cancelled the sale. The investment his father was so proud of, the star asset in the company's international profile, was staying inside the CanWest stable.

The most attentive shareholders—institutional investors—voted on the decision with their feet. A stock that had traded at nearly \$10 before the cancellation of the sale shed an average of 50 cents a month over the next year. The smart money saw that CanWest had missed a \$1.5-billion benefit: In addition to a sale price that even conservative estimates put at \$1 billion, the deal would have removed a half-billion in debt on the books at the Australian operations.

A month later, in July, 2007, a defiant Asper defended his decision—and a 36% drop in CanWest's quarterly profits. There was no need to liquidate the Australian network for cash, he told analysts on a conference call. "I don't think there's any point just having

[the money] sit there in a bank in Canada,” Asper said.

But he was missing the point. The money wasn't supposed to sit in a bank. It was supposed to pay down debt. Of all the opportunities Asper missed to control CanWest's debt, this one would prove to be the most damaging. “The trouble with Ten was that it just became too good of a business for them,” says Diceman. “It became too big and too valuable for Asper to say this was the right time to sell.”

Certainly there was a rationale for keeping it—and there was a rationale for the trust decisions too. But if CanWest had pulled the trigger on trusts and Ten rather than hesitating, it would have entered the recession with a debt as low as \$1.5 billion, possibly even less. Instead, it staggered into the jaws of a recession in late 2008 with a debt load approaching \$4 billion. And the slowdown meant that advertising sales—which CanWest depends on for 77 cents of every dollar it makes—plummeted.

“This was a company that was not properly capitalized for a downturn,” Diceman says. Asper, in other words, simply never planned for a rainy day.

**I**t was no accident that Asper's fateful Ten pitch was made at the King Edward Hotel. For Winnipeg-based CanWest, the King Eddy has long served as a home away from home, an elegant venue just a couple of blocks from the financial epicentre of King and Bay.

In January, 2007, when the fate of the Ten network was still an open question, Asper called a press conference at the hotel. As he stepped to the microphone inside a capacious meeting room, he glanced, smiling, at a row of TV cameras pointed his way. Some of the crews were from CanWest's own Global TV; others had been dispatched by its rivals CTV and CBC.

“By now you've probably heard the news,” Asper quipped. Word of CanWest's \$2.3-billion purchase of Alliance Atlantis Communications Inc. was among the worst-kept secrets around town that week, rendering the press conference slightly anti-climactic. Still, this was Asper's crowning moment, the first major deal he'd made without his father looking over his shoulder.

The takeover saw CanWest acquire 13 specialty TV stations, including popular channels like Showcase, HGTV and the Food Network. The transaction held crucial strategic importance. In contrast to conventional TV networks like Global,

which must depend solely on the whims of advertisers for revenue, specialty channels enjoy a steady stream of monthly fees from cable and satellite customers.

The fact that CanWest owned few specialty TV channels had been a glaring weakness in the company's portfolio. The problem had become particularly acute in recent years as rival CTV began using the steadily increasing revenues from specialty assets like TSN and Bravo to undermine CanWest. CTV regularly outbid Global for the Hollywood shows that the networks rely on for ratings and revenue; now Global had a way to fight back. “It makes great sense,” CIBC World Markets analyst Bob Bek wrote in a research note.

But the purchase of Alliance Atlantis came at a hefty price. Lacking for cash, CanWest had to partner with American investment bank Goldman Sachs, which agreed to foot most of the bill. CanWest was contributing a mere 36% of the equity. To make it worth Goldman Sachs's while, CanWest struck an intricate agreement that worried analysts.

CanWest agreed to combine Global TV with the Alliance channels to create a single business unit that, in 2011, would be divvied up in direct correlation to the financial performance of the assets. At that time, CanWest would be given a price that it would have to pay to buy back full control from Goldman Sachs. For CanWest to walk away with at least a 50% stake, the company needed EBITDA (earnings before interest, taxes, depreciation and amortization) of the combined TV operations to reach at least \$200 million by 2011. EBITDA of \$250 million would give CanWest 58%; of \$300 million, 63%. “It's a performance-driven model,” Asper said, touting the cleverness of the deal. The better job CanWest did at operating its TV businesses, the lower the price to buy out Goldman Sachs.

Quite apart from pushing the envelope on federal ownership rules, the deal was fraught with risk. Goldman Sachs isn't known for coming out on the losing end of deals, and analysts wondered what CanWest was getting itself into. Though Asper was all smiles at the announcement, the deal reeked of desperation.

The stable of Alliance Atlantis channels and Global were estimated to be making combined EBITDA of about \$160 million, meaning the targets set by the deal were within easy reach—so long as the economy kept doing its bit. But since then, advertising markets have fallen flat, conventional television has struggled, and it's safe to say that the earnings figure for those assets hasn't risen to meet the projections CanWest needs.

So when 2011 arrives, the math will

likely have worked in Goldman Sachs's favour. A reorganized CanWest will face a buyout price of between \$600 million and \$1 billion. If the company can't pay the tab, the agreement allows Goldman Sachs to sell its stake in the broadcasting business to the highest bidder.

"This is not the sword of Damocles hanging over the company's head," Asper insisted in an interview after the deal. But making the Alliance Atlantis acquisition on what amounted to a Goldman Sachs credit card undermined Bay Street's confidence in him. It also raised CanWest's debt to \$3.8 billion.



After the Alliance Atlantis purchase was announced, it was assumed on Bay Street that CanWest would sell the Australian TV network to pay down debt. And if *that* wasn't happening, investors wondered aloud what Plan B was.

To these questions, Asper responded that the company was seeking several "regulatory fixes" that could be worth hundreds of millions of dollars. Atop that list was CanWest's push—alongside its rival CTV—to reap specialty channel-style revenues for its conventional network by charging cable and satellite companies to carry the signals.

Beyond that change, which would bring in more than \$70 million annually, CanWest was also mounting a costly legal fight, again alongside CTV, to loosen federal restrictions on pharmaceutical ads—worth \$350 million annually to the media industry, by some estimates.

Neither of these fixes, nor any of the others proffered by Asper, materialized. As the calendar turned to 2008, with a debt approaching \$4 billion, CanWest was running out of ideas.

The first signs of deep financial trouble began in the fall. With advertising revenues declining, CanWest broke a bank covenant that required the company to keep its debt below 5.75 times its pretax earnings. Asper responded by negotiating breathing space with his banks, and told analysts the situation was under control.

Before long, CanWest broke the same covenant again as revenue fell further. On Oct. 31, 2008, DBRS raised the first of many red flags, putting CanWest's debt under review. On Nov. 11, it warned that some senior subordinated notes carried "below-average recovery prospects." To translate bond-rating speak: CanWest was hemorrhaging.

The free fall in CanWest's shares soon

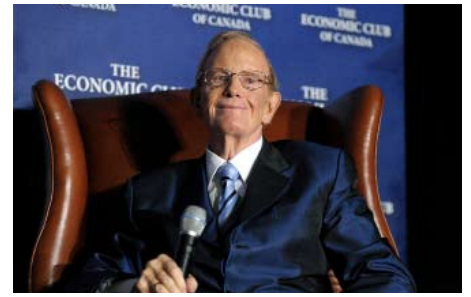
worsened. It became more apparent that the company was going to default on interest payments to bondholders, and the shares, which had sold for \$6 a year earlier, dropped to less than a dollar. Asper tried his best to shuck off the “penny stock” stigma. But what individual retail investors thought began to matter less and less as the bondholders exerted more influence over the company.

By March, the bondholders were owed millions in outstanding interest payments, and had the right to call more than \$760 million owed to them by CanWest’s holding company, CanWest Media Inc. Instead of forcing CanWest into foreclosure, the group—led by Toronto-based West Face Capital and U.S. hedge funds GoldenTree Asset Management and Beach Point Capital Management—demanded seats at the table, and the ultimate say in what would happen to CanWest’s assets.

All three funds were specialists in distressed companies—“vulture” funds. In exchange for their debt, they would take the vast majority of the shares in a restructured CanWest. The terms were simple: If CanWest was going to survive, it had to get used to answering to a small group of powerful new partners. And the Asper family would have to get used to not calling the shots.

**T**he crisis at CanWest has taken its toll on Asper. But he has done his best to not let it show. On a warm spring night in May, the CEO, fresh from meeting with the CRTC, was found boarding a Porter Airlines flight in Ottawa for the short hop into Toronto’s downtown Island airport.

Inveterate dealmaker Ted Rogers tried to play white knight at CanWest shortly before his death



Asper, who’d ditched his suit for casual attire, greeted a few other passengers with a smile. But his mood was solemn as he slumped in his seat. It looked inevitable that CanWest was headed for a major restructuring—and possible dismantling. No white knight had emerged to save the company. Prem Watsa, the billionaire behind Fairfax Financial Holdings, had been buying CanWest shares for the past two years, amassing 22% of the non-voting stock. But in this instance, the famously savvy investor had made the wrong call: Owning equity, not debt, meant he was shut out of the endgame as the debtholders took over.

Another redemptory prospect had briefly surfaced back in November, when an ailing, bedbound Ted Rogers phoned CRTC chairman Konrad von Finckenstein. Rogers was blunt, offering to save Global TV if the regulator would relax rules and let Rogers Communications own two conventional television networks. Von Finckenstein said no. Rogers died two weeks later, and the plan was never revisited.

By the time of Asper’s May excursion to Ottawa, relations had already frayed inside the Asper family, as his siblings David, an executive vice-president at CanWest, and Gail, corporate secretary and a

director, watched the value of their family business dwindle. Close friends say that when the family gathered in Winnipeg in April to mark Passover, the atmosphere around the dinner table was tense as the conversation turned to what had gone so terribly wrong at the company. The answer was obvious: CanWest had carried too much debt for too long, and had missed several opportunities to dig itself out. On Bay Street, a new term had been coined—"CanWest fatigue"—as bankers grew weary of the same debt story playing over and over, with the company doing little to solve it.

As Asper left the plane in Toronto and headed for the short ferry ride that takes Porter passengers to the mainland and into a fleet of waiting taxis, he paused to ponder the company's looming restructuring. "There's still a long way to go," he said. The CRTC aside, Asper was spending most of his days on a treadmill of meetings with banks, bondholders and lawyers, often running from one to the next, trying to keep all groups happy.

Throughout the negotiations, one all-too-familiar topic kept weighing down the talks: Australia. The bondholders and other creditors were fighting over the sale of Ten—whether to liquidate the network immediately for cash, or wait for a better time to sell. The bondholders finally won out in September when a small window opened for an Australian deal.

With advertising markets in the country showing signs of life, investor interest in media assets began to pick up. Watching the rise in antipodean media stocks, the bondholders instructed Asper to board a plane for Australia and work a deal to sell the network in the open market.

The asset that had been valued at more than \$1 billion was sold for \$634 million.

The deal also allowed CanWest to erase from its books \$582 million of debt that was linked to Ten. All told, the divestment was worth more than \$1 billion—not enough, by this point, to save the company.

The sale of the Australian business marked the end of CanWest's international ambitions. But the price Ten fetched signalled something else: The bondholders were now running the business, period. Accordingly, a few weeks later, CanWest filed for protection under the Companies' Creditors Arrangement Act.

**“I** f I could go back in time,”

Leonard Asper says, his voice flat and serious, “I would have certainly focused to a greater degree on ways to reduce the debt.”

It is Oct. 6, the day CanWest has filed for court protection from its creditors. What might he have done differently? He acknowledges that the trust sale and buyback could have been handled better. And the Australian situation still bothers him. “There might have been a window where—if you knew everything you knew today—you would have just dumped it,” Asper says. “But I can’t look back and regret that decision. Decisions of companies get made by not one person. There was a collective view that we should hold on to Ten. And it turns out that, with everything else that happened, it wasn’t the right decision.”

Asper then cuts this part of the conversation short. It’s no use revisiting decisions. “You could pick any of these things. And I think once you do that, you start driving yourself crazy.” **R**