

***“Income Trusts:  
Made in Canada Success Stories”***

**NOTES FOR REMARKS**

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## **Introduction**

Merci madame Hubert de votre introduction. J'aimerais également remercier le Cercle Canadien de Montréal de m'avoir invité aujourd'hui.

Groupe Pages Jaunes est fière d'être une entreprise montréalaise, et nous apprécions le rôle que le Cercle Canadien joue en fournissant à certains de nos principaux dirigeants une tribune pour parler des questions de l'heure. J'aimerais saisir l'occasion pour vous livrer mes pensées sur l'émergence des fiducies de revenu comme véhicule d'investissement.

Les fiducies de revenu sont un exemple de succès "made-in-Canada". Compte tenu du fait que nous sommes la deuxième plus importante fiducie de revenu – après Canadian Oil Sands – et que nous sommes LA plus importante fiducie commerciale au Canada, je crois que Groupe Pages Jaunes offre un exemple frappant de la façon dont ce type d'investissement peut servir les intérêts des investisseurs, employés et autres parties prenantes des entreprises sous-jacentes et de l'économie canadienne toute entière.

## **Controverse**

Du point de vue des dollars investis, il serait difficile de nier le succès des fiducies de revenu. En novembre dernier, la bourse de Toronto comptait 230 fiducies actives. Collectivement, elles représentaient une valeur de marché de 190 milliards. En décembre dernier, 75 fiducies ont été ajoutées à l'indice composé S&P/TSX avec une valeur de marché d'environ 5%. D'ici la mi-mars, cette valeur augmentera à 10%. Et ce pourcentage pourrait encore s'élever.

While the mass investment appeal of income trusts is a recent development, some trusts have been around for years. In fact, there are many examples of income trusts with proven track records of sound reporting and disclosure practices. In addition, more and more relative newcomers like YPG have senior executive teams with previous work experience in large Canadian public companies who are accustomed to the rigors of public company management.

That being said, we recognize that there is some concern amongst investors about reporting, disclosure and governance issues needing to be addressed in order to provide a consistent framework for investment decisions. We feel we need to respond to these concerns. We want to address some of the misconceptions people have developed about trusts and the uncertainty this generates.

Just look at what happened last fall when the Finance Minister of the day speculated aloud about finding ways to tax income trusts. Overnight, hundreds of millions of dollars were wiped off the books of Canadian investors as media-fuelled speculation raged. Our company's data showed that the vast majority who sold our units on this news were retail investors – your friends and neighbours and family.

In fact, more than 100,000 retail investors hold units of Yellow Pages Income Fund. The average holding is 1,500 – or about \$25,000 at recent stock price. And these are the kind of investors who decided their risk tolerance would not support the Finance Minister's speculations.

But we also have more than 200 institutional investors. Together they hold about 325 million shares. And when the market corrected a few weeks later, these are the investors who jumped back in. In other words, speculation about the laws and tax treatment led to a massive transfer of wealth from the portfolios of ordinary Canadians to those of the professional money managers.

Everyone would benefit if we could put an end to such uncertainties in the market. Thousands of our fellow Canadians turn to income trusts as a way to protect their families' assets and to save for their retirement.

So today, using the YPG story as a starting point, I want to do three things.

- First, I would like to share my views about the income trust structure, specifically in terms of what it has done for us and our investors so far and what it can do for us going forward.
- Second, as we are increasingly recognized as a leading directory player not just in Canada, not just in North America, but worldwide, I want to show that the income trust structure is well suited to making companies, like YPG, global leaders.
- Finally, I want to show my support for improved reporting and disclosure guidelines that will help provide a market framework in order to create a climate of certainty for all investors, retail and institutional alike.

### **The Structure**

Comme la plupart des investisseurs le savent fort bien, les fiducies de revenu sont structurées de façon à détenir l'avoir et la dette d'une entreprise active sous-jacente – par exemple, le Fonds de revenu Pages Jaunes est le détenteur de Groupe Pages Jaunes. Au lieu de conserver leurs gains ou de distribuer leurs profits sous forme de dividendes, les surplus de flux de trésorerie de la société opérante sont mis à la disposition de la fiducie qui en assure la distribution à ses porteurs de parts.

Quel genre d'entreprise peut avoir avantage à adopter une telle structure? Cela convient à des entreprises qui génèrent des flux de trésorerie stables – je reviendrai sur ce point dans quelques instants. Bien des entreprises du secteur des ressources et des services publics se sont transformées en fiducies de revenu. Il en est de même

pour les fonds de placement immobilier (REIT). D'autres entreprises qui ont adopté la forme d'une fiducie de revenu vont de l'impression de chèques aux entrepôts frigorifiques. Généralement, ces entreprises jouissent d'un haut niveau de stabilité ou d'une longue durée de vie de leurs actifs. Elles sont bien établies et jouent un rôle de premier plan dans leurs marchés respectifs.

### **Groupe Pages Jaunes – Un autre succès canadien**

Groupe Pages Jaunes fait partie de ces entreprises. Dans deux ans, nous allons célébrer 100 ans de réalisations et de croissance, mais nous sommes aussi très bien positionnés pour le 21<sup>e</sup> siècle. Nous avons des droits exclusifs sur le logo des "doigts qui marchent" et sur la marque de commerce Pages Jaunes<sup>MC</sup> au Canada, et notre marque bénéficie d'une grande notoriété aussi bien pour l'imprimé qu'en ligne.

Aujourd'hui, GPJ publie plus de 330 annuaires au Canada. Nous sommes le principal éditeur canadien des annuaires. Mais nous avons aussi une présence solide sur Internet. Nous avons deux annuaires en ligne, PagesJaunes.ca<sup>MC</sup> et Canada411.ca, ainsi qu'un réseau de sept sites urbains dont MontrealPlus.ca et TorontoPlus.ca. Et depuis la semaine dernière, nous sommes les leaders dans les annonces classées en Ontario.

Avec près de sept millions de visiteurs uniques chaque mois, nos sites font partie des sites les plus visités par les internautes canadiens. Notez bien que je n'ai pas dit le site Web canadien le plus visité. Lorsqu'il s'agit d'offrir aux Canadiens l'information qu'ils recherchent en ligne, nos sites se classent parmi les plus importants sites au monde.

D'autres entreprises de médias connaissent des moments plus difficiles. Le public est devenu de plus en plus fragmenté pour des médias comme la musique enregistrée, la télévision grand public, les quotidiens, les magazines de consommation et les livres. Les recettes de cinéma, la télévision et la musique souffrent également de

la concurrence de l'Internet. Mais si ces véhicules médiatiques traditionnels souffrent, les médias spécialisés et les nouveaux médias sont en plein essor, y compris les sites Internet pour consommateurs, la télévision par câble et par satellite, les jeux vidéo et les services de radio par satellite... et les annuaires font partie de la catégorie en croissance.

L'utilisation d'annuaires imprimés, en ligne et sans fil continue d'augmenter. La plupart de ceux qui sont présents ici aujourd'hui se sont servis d'un annuaire téléphonique au cours du mois passé, que ce soit en format imprimé ou en ligne. La plupart d'entre nous se servent d'annuaires assez régulièrement parce que nous essayons d'obtenir des informations spécifiques. Souvent, nous avons recours aux annuaires à la suite d'un "événement marquant" de notre vie.

En même temps, d'importantes possibilités de croissance s'offrent à nous – en termes d'utilisation de nos produits imprimés et en ligne. Le potentiel des annuaires en ligne est d'autant plus grand que les gens se tournent vers Internet pour obtenir davantage d'information.

The boom in the amount of information available online has provided a particular challenge. The technology keeps growing beyond the capacity of the search engines to deliver what people are looking for. Netscape was the early leader in retrieving information quickly and easily, but soon it could not keep up with the volume of information available.

Then along came Google, with its search algorithms that help find information by ranking websites by popularity. It has proven very effective when you want to find information on topics for which thousands or tens of thousands or millions of people before you have created a path to the most suitable site. But it is less useful if you want to find information at the local level. If my family and I are expecting to move, we

may Google to obtain advice on movers, but what is the fastest way to find information on moving? Your teenage daughter may use Google to get the latest information about Coldplay's tour, but how does she find where is the location of the show in the next city?

So there is a growing market for information that we need for our daily lives in our own communities – information that takes advantage of the Internet's ability to post new information quickly, and its ability to provide complete and consistent information. This is a concept we call dynamic local relevance, and it is a key strength of YellowPages.ca™.

At Yellow Pages Group, we want to be at the forefront of finding new ways for consumers to use the Internet for local searches. We will build on our content and improve our search capacity. We will work with various partners, such as Google, to maximize our reach on behalf of our customers. We want to be in the way of every search in a remarkable way. As a market leader we are well positioned to evolve with the medium.

And the markets have responded favorably. In 2002, Bell Canada sold YPG for \$3 billion. On August 1, 2003, the Initial Public Offering of the Yellow Pages Income Fund earned proceeds of \$1 billion. Today, we have a market cap of approximately \$8 billion – a good sign that investors have confidence in our future.

That confidence has been rewarded by growing distributions. Since going public, we have distributed about \$530 million to our unit holders. Our first distribution in August, 2003, was at \$0.825. Last week, we announced a fourth increase in distributions since the IPO to \$1.03.

We are able to reward our unit holders because of our performance but also because YPG has steady and consistent revenue growth with little cyclical movement. Our cash flow is stable and growing, and we have a strong track record of recurring

revenues. We have high margins and low capital expenditure requirements. In other words, we have all the attributes that investors are looking for when investing in the income trust sector. We are ideally suited for the income trust market.

Income trusts are not – or at least, in our view, should not be – a vehicle to be used indiscriminately by just any company. Income trusts are ideally suited to companies with stable, predictable cash flows. The structure's appeal lies in its ability to allow the operating company to return excess operating cash flow to investors in a tax-efficient fashion, thereby unlocking value previously buried away in mature divisions of large corporations, or simply not recognized in a past era of EPS-driven, or future growth-driven capital appreciation. At the end of the day, the income trust structure exemplify the "Cash is King" motto of value investing – we already know that KKR (our previous owners) bought into it; we are confident Warren Buffett would too if he were Canadian.

At the same time, an income trust format has not impeded our ability to innovate or to make acquisitions. An income trust format did not prevent us from raising \$2.55 billion to acquire Advertising Directory Solutions Holdings Inc. in Western Canada. We bought the business from BAIN Capital in a deal that included \$1.7 billion in equity. We will continue to expand through growth and acquisitions. And the management discipline of producing the distributions month after month actually fuels productivity, growth and innovation.

### **Making the Rules Clear**

We are able to grow. We are able to innovate. And we are able to distribute a large portion of our free cash flow to our unit holders in a time efficient way through an income trust structure.

In a post-Enron world, investors are wise to keep a sharp eye on innovative ways to earn a healthy return on investment. When we meet with investors, particularly newcomers to the world of income trust investing, the question often arises as to whether the returns offered by income trusts are sustainable over the long term. They also ask whether unit holders of an income trust enjoy the same kinds of protection that are offered to the shareholders of a stock company. These questions point to two areas for improvement. The first relates to consistency in the way income trusts calculate and report distributable cash; the second pertains to the governance regime that protects the rights of unit holders.

In a well-structured income trust, the excess cash generated by a company is not taxed as earnings; rather, it is available for distribution directly into the hands of the investors where it is taxed according to the nature of the distributions and the investor's tax profile.

The challenge is to ensure that the distributable cash figure presented by management is a fair reflection of sustainable cash generation at the time of distribution. Investors need to have confidence that the information they receive is accurate. They need information that they can compare to other investments before they make their decisions.

The difficulty is that income trusts use different, non-standard bases for their distributable cash calculations. In a recent S&P discussion document on income funds and distributable cash, across a sampling of 40 income trusts which included YPG, S&P found 19 different definitions for distributable cash.

At YPG we calculate distributable cash based on Adjusted EBITDA. You all know EBITDA as the non-GAAP measurement defined as earnings before interest, depreciation and amortization. At YPG we had to use "Adjusted" EBITDA when we took the company public in order to exclude accounting distortions resulting from the

application of purchase accounting, among other things. Our Adjusted EBITDA also excludes restructuring and other one-time charges that are clearly non-recurring. Our disclosure identifies these adjustments. Had we not “adjusted” our EBITDA to remove these accounting and other distortions, we would have reported an incremental \$0.08 of unsustainable distributable cash per unit on an annualized basis in 2003, and fundamentally misled the market.

After the determination of Adjusted EBITDA, to arrive at distributable cash, we subtract cash interest expenses, cash taxes and maintenance capital expenditures necessary to ensure the sustainability of the business. We exclude non-recurring, or special project capex initiatives; but provide full disclosure to investors who may wish to take a different view. The objective is to smooth out peaks and valleys, and provide a sustainable, long term foundation for our distributions.

This is one way to calculate distributable income and we think it is a good one. We do not believe distributable cash needs to become a GAAP-based item. For years, sophisticated investors and analysts have used EBITDA as a reliable non-GAAP metric for valuation purposes. In fact, as S&P points out and as our own experience shows, accounting conventions can – and do – cause distortions. We support the initiative by the Canadian Association of Income Funds to establish a framework for reporting distributable cash and providing supplemental disclosure around distributable cash. In the U.S., the National Association of Real Estate Investment Trusts has developed industry standards; so has the Canadian Institute of Public and Private Real Estate Companies. The time has come to raise the bar and establish best practices for plain full disclosure on distributable cash across the income trust sector.

L'autre question que les investisseurs sont portés à considérer lorsqu'ils déterminent si les fiducies de revenu conviennent à leur profil est celle de la gouvernance d'entreprise. Une étude récente d'Industrie Canada en arrive à la conclusion que les investisseurs des fiducies de revenu cotées en bourse bénéficient déjà d'un régime de protection très près de celui des actionnaires ordinaires, même

s'ils ne disposent pas des mêmes recours en justice prévus par la *Loi canadienne sur les sociétés par actions*.

Par exemple, en général les porteurs de parts ne peuvent faire valoir leurs préoccupations lors d'une assemblée générale ou spéciale sous forme d'une proposition. Ils n'ont pas non plus les mêmes droits de se présenter en cours pour demander une mesure de redressement s'ils croient que la direction ou le conseil d'administration ont exercé leur autorité de manière abusive.

Les gouvernements provinciaux étudient des façons d'établir des régimes de gouvernance qui protégeront les droits des porteurs de parts. GPJ voit d'un bon œil ces efforts destinés à établir un cadre législatif susceptible de promouvoir la confiance des investisseurs.

## **Conclusion**

Clearly, income trusts have emerged over the past decade as an innovative way for companies to raise capital.

The income trust structure is not meant for all types of business, but it is well suited to a company like YPG – a company that provides continuing value to advertisers through both our print and online formats. A company that has a solid record of earnings performance that goes back nearly a century. And a company that is well positioned for growth and continued earnings stability in the digital age.

I am neither an accountant nor a lawyer, but I support the efforts of finance and legal professionals seeking to address the reporting and governance issues that need to be resolved to bring consistency and clarity to income trusts. We endorse the efforts to create a framework for improved reporting and disclosure of distributable income, and to protect unit holder rights under the governance provisions of provincial statutes.

The bottom line is this: Canadian business must raise investment revenues so that we can compete in a global economy. Income trusts are a made-in-Canada success story. They have been remarkably successful in helping companies like Yellow Pages Group become major players in their respective business markets as well as in the Canadian market for capital.

We believe income trusts play an important role in the Canadian economy. We believe that the Government of Canada and the provincial governments should support the responsible growth of this asset class. And we believe that income trusts will continue to play an important role in helping to build the financial security of Canadians for generations to come.

Thank you. Il me fera maintenant plaisir de répondre à vos questions.