Shaw, Once Appealing, Hits Telecom Vortex

By Mark Heinzl, The Wall Street Journal
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WHO said Warren Buffett didn't get burned by technology stocks?

The Oracle of Omaha looks smart for having steered clear of the technology bubble, favoring his collection of well-established businesses in insurance, consumer products, manufacturing and other industries. This week, however, Mr. Buffett's holding company, Berkshire Hathaway Inc., signaled it sees opportunities in the beaten-up telecommunications sector, with a $100 million investment in fiber-optic telecom carrier Level 3 Communications Inc., part of a broader $500 million investment along with fund managers Longleaf Partners and Legg Mason.

But Level 3 isn't Berkshire's first bet on communications. Another Berkshire holding -- Canada's Shaw Communications Inc. -- has recently been sucked into the postbubble vortex.

Berkshire held about 9% of the Canadian cable, Internet and satellite service provider as of Berkshire's last report, March 31, having built up the position gradually since the second quarter of 1999 at prices well above current levels. Investors were attracted to Shaw for its dominance of western Canada's cable-television market, as well as Shaw's fast-growing high-speed Internet service, and its burgeoning satellite television and fiber-optic telecommunications businesses. It isn't clear if Berkshire has changed its Shaw holding since March 31; Berkshire didn't respond to requests to comment.

Shaw's stock price held up well during 2000 and 2001 even as scores of Internet and communications stocks plunged as the bubble burst. The Calgary, Alberta, company had won kudos from the investment community for avoiding pitfalls that have hurt some of its industry peers, such as acquiring media and entertainment content or entering the brutally competitive wireless-communications field.

But investors have suddenly turned sour on Shaw as well amid the company's recurring losses, cable-customer defections, disappointing Internet-subscriber growth and allegations of aggressive accounting. Shaw's once-resilient shares have lost half their value this year. In 4 p.m. composite trading yesterday on the New York Stock Exchange, the stock was at $11.36, off 10 cents on the day, and down from a 52-week high of $23.94.

Shaw lost about 19,000 basic cable subscribers in the company's fiscal third quarter, ended May 31, a once unheard-of trend the company attributed to a recent price increase, competition with satellite providers and seasonal factors. The company had 2.1 million basic-cable subscribers at the end of the quarter.

Shaw also recently cut its forecast for Internet-subscriber growth this fiscal year to 200,000 from 250,000, citing "intense competition" with telecom carriers.

Shaw officials didn't respond to requests to comment for this article. Shaw's strategy is a "hedged bet in communications," because Shaw provides cable and satellite service, which will "drive profitablity quicker," Jim Shaw, the company's chief executive officer, told analysts.

But analysts forecast continuing losses for Shaw for the next few years at least. Shaw posted a loss of 90.9 million Canadian dollars (US$60.1 million) for its third fiscal quarter, which included a nonrecurring gain of C$218 million and a C$269 million write-down of Shaw's investment in GT Group Telecom Inc., a struggling fiber-optic carrier that recently filed for court protection from creditors. Revenue, however, was up 14% to C$493.6 million in the quarter, and cash flow from operations, a key measure for cable companies, shot up 59% to C$98.6 million.

Still, skeptical investors are focusing more on Shaw's debt load of C$3.5 billion and its heavy capital-spending requirements. Adding to their concerns is a recent report by independent Toronto-based research firm **Veritas Investment Research Corp**. that charges Shaw with "aggressive accounting policies."
"Shaw's balance sheet, income and cash flow statements have been skewed by capitalized labor costs and equipment subsidies" and other factors that defer expenses and boost reported results, the **Veritas** report says.

For example, the "investing activities" section of Shaw's fiscal third-quarter cash-flow statement contains C$16.1 million of "additions to equipment subsidies," costs incurred due to Shaw's practice of selling its satellite equipment to subscribers at a loss, **Veritas** analyst **Neeraj Monga** notes. Those costs are included in the "deferred charges" asset category on Shaw's balance sheet, and then gradually expensed on its income statement, he says. Shaw had C$240.8 million of deferred charges as of May 31.

Since the costs are deferred, rather than booked entirely as they are incurred, Shaw is "trying to manage" the company's income statement "in a favorable light," **Mr. Monga** says. While **Veritas** acknowledges that Shaw's accounting practices are "in accordance with" Canadian generally accepted accounting principles, the firm argues that Shaw's approach "muddles comparison with other Canadian and U.S. competitors."

On the conference call with analysts, Shaw Chief Financial Officer Ron Rogers stood by the company's accounting policies, saying that "everything's in accordance" with Canadian GAAP.