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Is Shaw's wireless success enough to offset its cable business declines?

Shaw Communications' new wireless unit – formerly known as Wind Mobile – is thriving as the company's legacy cable business declines

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It’s been more than three years since Shaw Communications Inc. made what chief executive officer Brad Shaw called “the pivot,” jumping into telecom with both feet with the $1.6-billion acquisition of wireless startup Wind Mobile. To pay for the deal and related spending, the family-controlled company shuffled its television operation, Shaw Media, over to Corus Entertainment (also controlled by the Shaw family) for $1.9 billion in cash, plus Corus shares worth a further $800 million.

Since the acquisition, Wind Mobile—now dubbed Freedom Mobile—has been thriving. The division has attracted almost 500,000 new subscribers under Shaw's ownership—increasing its subscriber base by 50%, to about 1.5 million, and grabbing market share away from the Big Three (BCE, Rogers Communications and Telus).

However, that success may be obscuring troubles beneath the surface. Shaw still hasn't bundled wireless with its residential services, something that could help persuade customers to stay with the company. And other problems are bubbling up at Shaw's cable operation—its TV, Internet and home phone business—which accounts for about 90% of its EBITDA (earnings before interest, taxes, depreciation and amortization).

The move into wireless was all part of a plan to help the Calgary-based player tackle the threat posed by its biggest rival, Telus. Both companies sell residential services in Alberta and British Columbia; Telus, the Vancouver-based telephone company that did not traditionally offer television, swooped into the video market about a decade ago with the launch of Optik TV. The Internet protocol television (IPTV) service finally offered an alternative to cable, and by 2015, Telus had more than a million TV customers. As Telus surged, Shaw shed hundreds of thousands of subscribers, shaking the bedrock of the legacy cable operator.

Shaw’s father, JR Shaw, started the business in the 1960s and spent years consolidating smaller cable players, building Shaw into the country’s fourth-largest cable company by 1985. (It’s now the second-largest after Toronto-based Rogers). Despite its size, Shaw has long remained a family affair: JR, now 84, remains executive chair, and Brad’s older brother Jim (who died last year at the age of 60) was also CEO for a dozen years. The Shaw clan maintains control of the company through a dual-class share structure.

Shaw made a few stabs at the wireless business (selling an early investment in Fido, an aborted plan to buy airwaves and build its own network, and an investment in WiFi hotspots) but had no real strategy before buying Wind Mobile. Part of the rationale for the investment was to one day bundle cellular service with Shaw's TV, Internet and home phone services, emulating the model used by Telus and the other national carriers.

Freedom Mobile's momentum has many financial analysts bullish about Shaw's prospects. Out of 18 analysts tracked by Bloomberg, 10 have buy ratings on the stock, five have holds and three have sell ratings. Freedom started off with a patchy network in urban areas of Ontario, British Columbia and Alberta, and the service didn't work with many of the most popular smartphones. Shaw has spent $785 million on capital investments and equipment costs associated with its wireless business since buying Freedom, leading to faster speeds and more reliable coverage. (Shaw started looking for a buyer for its Corus shares last summer, since a sale could provide more cash to invest in wireless.)

Those improvements finally led to an agreement with Apple Inc., allowing Freedom to sell the iPhone directly to customers beginning in late 2017. It was a pivotal point for the carrier that “changed all aspects of our wireless business,” according to Shaw president Jay Mehr. In 2018 alone, Freedom added about 320,000 contract customers. And subscribers are buying more expensive plans too: The company’s average monthly charge for wireless customers increased to $41.99 as of the end of November, up 16% since Shaw bought the carrier.

Even Shaw's cable division has a number of factors working in its favour, says BMO analyst Tim Casey. The company currently has an edge over Telus on faster home Internet across its entire coverage area, and two years ago it launched a new Internet-based TV platform to woo customers back from IPTV. Plus, it can count on a “solid balance sheet,” says Casey. But the analyst, who has a hold rating on the stock, cautions: “Unfortunately, execution remains inconsistent.”

Veritas Investment Research analyst ***Desmond Lau*** has a sell rating on Shaw's stock, warning that the cable operation is losing television subscribers at a much faster pace than it's picking up Internet customers. The profit margins on television service are not as high as those on Internet (because cable companies must pay for the rights to the television content, increasing the expense of serving each customer). That means Shaw could replace lost TV customers with fewer Internet subscribers and still increase its overall EBITDA. But to do that, ***Lau*** estimates Shaw needs to gain 35 Internet customers for every 100 TV subscribers it loses, and recent trends show the company is only gaining seven Internet customers for every 100 TV subscribers lost.

He says Shaw missed a chance to take Telus on more aggressively by investing in upgrades to its Internet speeds. Telus's legacy copper telephone wire infrastructure was much slower than Shaw's cable Internet, but Telus has been steadily building fibre-optic cable to customers' homes for the past several years and now reaches more than half of its service area with the faster service. Telus can now offer gigabit-persecond download speeds in many areas, surpassing Shaw's top offering for residential customers of 600 megabits per second. Both are fast and likely sufficient for most homes, but Telus can now run away with a marketing advantage.

“It would have made sense to upgrade to gigabit speeds on Internet in 2015, when Shaw was first talking about it. Now [Telus CEO] Darren Entwistle is saying up to 70% of Telus's footprint will have fibre by the end of this year,” ***Lau*** says. “The window of opportunity Shaw should have capitalized on—where they could have offered gigabit speeds—has passed. They still have the ability to do it but wouldn't gain as much of an advantage now.”

Another area of concern is a massive restructuring that the company undertook last year that included voluntary buyout offers. Those buyouts will ultimately see 3,300 employees leave the company—roughly 25% of Shaw's total workforce. That was five times more than the company hoped would volunteer for the generous packages—which, crucially, gave Shaw no right to turn down employees who wanted to take a payout.

The restructuring also includes a shift toward promoting online customer service and “self-install” options for TV and Internet. Shaw expects to save $215 million a year once the process is complete. But ***Lau*** is skeptical about whether those savings will materialize. The company introduced smaller restructuring plans in 2014 and 2015, promising annual savings of $125 million, but he says that by 2017, EBITDA at the cable division was $78 million lower than 2015 levels. “That makes me uncertain about whether Shaw will be able to achieve its promised savings this time.”

In a recent earnings call, Shaw’s Mehr reflected on the restructuring. "Most of the heavy lifting is behind us,” he said. “It really has enabled a new Shaw…a modernization of how we do business.” Still, it will all come down to execution, and as BMO’s Casey says, for Shaw, the cable division remains a “show-me story.”