How to squander a $52-Billion Empire: the Michael Sabia story

Missed opportunities, indecisiveness and a lack of vision cost BCE its head start in the cellphone and Internet game

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Michael Sabia, the chairman and CEO of BCE, desperately wants you all to know something. In fact, he'll tell anyone who'll listen. You've heard all the nasty talk about how BCE's board of directors botched the auction and sale of the storied company. Well, says Sabia, phooey to that. The complaints from bidders about management interference in the auction process, and the harried pace of the talks, just reflect the difficulty of selling a highly regulated company in Canada's small capital market. "The magnitude of the price put on the table," Sabia told *Maclean's*, polishing his pitch for why shareholders should accept the $52-billion deal of cash and debt, "is the strongest evidence our board succeeded in creating a very competitive process."

And so it goes. Another Canadian icon disappears from the markets -- not with a bang, but amid the whimper of a hundred investment bankers and lawyers, and with a CEO offering up a parting rationalization. Canadians are by now immune to the vanishing acts of this country's largest and most historic businesses. Molson, then Hudson's Bay Company, then miners like Inco and Falconbridge and now BCE and its Bell Canada subsidiary -- a combined 820 years worth of Canuck capitalism gone in the span of just three. Sure, BCE hasn't fallen completely into the hands of the Americans, since the Ontario Teachers' Pension Plan will ultimately own 52 per cent of the company, while its two U.S. private equity partners will hold the rest. But it's still dead to Canadian investors, and along with it, the shared interest that comes with owning one of the country's largest enterprises. Many analysts believe it's just a matter of time before Ma Ball gets carved up into tiny pieces and sold off completely.

Did it really have to end this way? It's impossible to say for sure, but it's become clear, looking back over Sabia's time at BCE, that more could have been done -- and done faster -- to make the company stronger, and therefore more impervious to a takeover. While Sabia did inherit a company bloodied by the failed empire-building of his predecessor Jean Monty, his plan to slash costs and spin off assets only took it so far. For all his financial wizardry, he presided over a time when his business changed from copper land lines to cellphones and the Internet, yet BCE failed to keep pace. As his massive renovation program wore on, and as opportunities passed BCE by, rivals pulled ahead. Investors were left with more questions than answers about BCE's future. Where would the company's growth come from amid increasing competition? And what exactly did Sabia want BCE to become? "The question has been raised whether he ever had a grander vision for the company," says Troy Crandall, an analyst with MacDougall, MacDougall & MacTier. "If he'd have done all the cleanup in three or four years and moved on, I'm not sure we would be in this situation with private equity buying the company today."

In other words, the biggest mistake the directors at BCE made wasn't in how they handled the recent auction process. Instead, when it became obvious Sabia was unable to light a fire under the company, the directors should have thanked him for his cleanup effort and found someone who could.

What a difference five years make. Back then, Sabia was hailed as BCE's saviour, the man who would right the ship Monty had steered onto the rocks. During Monty's four years in charge of the Montreal-based empire, he attempted to diversify BCE beyond just being a mere phone company, in much the same way Ted Rogers, with his sports channel, magazines (including this one) and baseball team, no longer ran a simple cable provider. A year after becoming CEO in 1998, Monty plunked down $10 billion to buy the 77 per cent of global long-distance carrier Teleglobe that BCE didn't already own. To help pay for it, he signed a complicated deal in which U.S. phone company SBC Communications paid $5 billion for 20 per cent of Bell Canada, with the right to force BCE to buy the stake back later on at a much higher price. And in 2000, Monty orchestrated the creation of Bell GlobeMedia by acquiring the CTV network for $2.5 billion and combining it with the *Globe and Mail*.

It took barely a year for the shine to come off Monty's convergence strategy. BCE failed to show how owning TV stations and a newspaper would add value. Meanwhile, Teleglobe, bleeding red ink, needed BCE cash just to keep the doors open. Before long, BCE's share price was in free fall. When Monty made the surprise announcement in April 2002 that he would step down and hand the reins to his president and chief operating officer, Sabia, investors were elated. By the end of that day the stock had jumped 17 per cent.

Sabia had never been front and centre before, but he came to the job with the calculating eye of a numbers guy. He was a policy wonk in the federal Finance Department in the 1980s when his boss, David Dodge, tasked him with hammering out the details for the Mulroney government's new Goods and Services Tax. Then, in the early 1990s, he joined Paul Tellier in the privatization of Canadian National Railway, bringing his sharp pencil to the bloated company and helping transform it into North America's most efficient railway. BCE shareholders hoped for more of the same from the freshly minted CEO.

Sabia appeared to deliver, at least at first. BCE cut the lifeline to Teleglobe the day Sabia ascended to the top job, and took a $7.5 billion hit over the whole mess. And he shrewdly negotiated a deal with SBC to bring all of Bell Canada back under the BCE roof. Other deals followed. To raise cash he off-loaded Bell Canada's valuable Yellow Pages directories business. After much to-ing and fro-ing he sold off a huge chunk of the company's stake in what's now known as CTV Globemedia. And then he hived off rural phone service in parts of Ontario, Quebec and Atlantic Canada into income trusts. Most recently, he sold satellite operator Telesat for $3.4 billion to a Canadian pension fund and U.S. aerospace company Loral Space and Communications. Nearly all of BCE's senior management has been replaced in a bid to rejuvenate the company. "In a company our size, facing some of the competitive challenges we were facing, it's a multi-year exercise to get it retooled," says Sabia. "I think the company has arrived at a very critical inflection point. "

Yet none of those moves did anything to lift BCE's flagging share price. And so earlier this year, Teachers began to push for the outright sale of the company. Some analysts argue investors never really knew how bad the situation was when Sabia took over, so his efforts weren't fully rewarded. But by several measures, BCE is worse off than it was when Sabia took charge.

The company had been Canada's largest wireless carrier with 3.5 million subscribers, but by last year had fallen to second place behind Rogers, while Telus, the third-largest cellphone provider, is right on its tail. And the early Internet lead BCE had with its Sympatico enterprise, back when it seemed everyone had a sympatico.com email address, faltered as Sabia's promise to upgrade its high-speed network failed to materialize. That has prevented BCE from mounting a counterattack as the cable companies like Rogers and Shaw encroached on its territory. By some estimates, between 2002 and 2006, Bell Canada lost more than one million local-phone customers to rivals offering home phone service both through conventional land lines and the Internet.

Meanwhile, Telus has made huge inroads in central Canada, BCE's traditional territory. Last year the Vancouver company beat out BCE to win a major network management contract with the government of Ontario, and it recently trumped BCE to supply the Department of National Defence with global telecommunications services. Both deals were BCE's to lose, say analysts. "I give [Sabia] a full 'A' for getting BCE out of the dog days of Jean Monty," says

Eamon Hoey, a telecom analyst. "But they moved far too slow on technology, and too slow to realize that competitors were at the door."

The truth is for all of Monty's flaws, he did more for shareholders during his term as CEO than Sabia had done up to the point that talk of a takeover injected life into BCE's share price three months ago. In the five years Sabia ran the company, it mustered a 29 per cent return, excluding dividends, with most of that coming in the first few months after he took over. In the Monty era, BCE shares ended up 62 per cent, even after the dramatic decline that accompanied the collapse of the dot-com bubble.

If Monty's greatest failing was that he took on too much, Sabia's is that he was paralyzed from taking any action at all. "Monty was rich on vision, but to the point that he was financially imprudent," says Malcolm White, a fund manager with Signature Advisors. "Sabia was the mirror image of that. He has been financially prudent, but at the cost of a vision for BCE."

There was a brief moment, in early 2005, when it seemed like Sabia might finally share his vision for where he wanted to take BCE. He talked of unleashing "creative destruction" on the company. He would demolish the silo-mentality that characterized BCE's many divisions while pushing the company into new technologies that would re-energize its business, like Internet telephone and providing television through phone lines. Those initiatives would require a massive investment in new fibre optic networks, and Sabia spoke of injecting $1.2 billion. But for whatever reason, his bold talk began to wane. "He started to talk like he had a dream of where he wanted to take the company, but he backed off," says Iain Grant, a telecom analyst with Seaboard Group. "Instead he turned Bell into this humble money harvesting machine."

Sabia denies he lacks a vision for BCE and insists his plan was unfolding on schedule. "Let's be Canadian," he says during a phone interview, before conjuring up a hockey analogy. BCE was just starting its third period, having been stabilized and rebuilt. The last third of the game would see the implementation of Sabia's vision.

And what was that greater mission that would have led the company higher? Upon hearing the question, Sabia launches into the kind of boilerplate-speak you'd expect from any tech executive -- or at least one trying to sound decisive. BCE would have "a competitive cost structure that enables it to competitively compete," says Sabia. It would deliver "leading edge network capabilities" and "information and entertainment services." Finally, BCE would offer "a truly differentiated customer experience."

"That's what we've been in the process of building," he says. "And that's the future direction we've been building toward."

Not exactly the kind of stuff to get investors' hearts racing. "I'll leave it to others to determine whether people regard that as a tantalizing vision," he says. "We believe it's a winning formula."

But the truth is that on the way to executing that formula, Sabia missed some very good opportunities to make BCE more competitive, and allowed rivals to pull far ahead. That was never more clear than when the opportunity came up to buy Microcell, a small wireless carrier known for its Fido brand and dirt-cheap rates. In 2004, Telus launched a hostile $1.1-billion bid for the company. Analysts were skeptical of Telus's offer because the two companies used different types of wireless networks. But the move would have given Telus access to Microcell's urban customer base. The same would have been true for Bell Mobility, which was losing customers over problems with its new billing software. (To his credit, Sabia turned down his bonus that year over the billing debacle.)

According to reports, Sabia was keen to make an offer for Microcell, but never pulled the trigger. In the end, Rogers Wireless swooped in with a $1.4-billion bid, which helped catapult it to the No. 1 spot in the sector. "Sabia didn't even try to bid," says one fund manager who owns shares in BCE, but asked not to be named. "There was an opportunity to change their mix. I don't think it was the only thing that needed to be done, but it could have helped them."

BCE was also a laggard when it came to letting customers watch TV through their phone lines, a crucial misstep given how much of the company's business the cable firms have stolen recently. Other Canadian phone companies are already way ahead. By early 2003, SaskTel in Saskatchewan and Manitoba's MTS Allstream rolled out the service in those provinces, while Telus has launched Internet Television in Alberta and Vancouver. As BCE scrambles to catch up, some investors are now saying Monty wasn't as far off the mark with his convergence strategy as he seemed, even if he paid too much for CTV. "At the time it didn't seem to make much sense, but six years later it could have had value," says the fund manager. "Ultimately what telcos need to do in order to be competitive is to rework television."

In looking at Sabia's legacy, it's impossible not to draw comparisons with his counterpart at Telus, Darren Entwistle. Both men faced baptisms by fire before they'd even settled into the corner office. And both faced roughly the same competitive challenge -- the telephone, as we'd known it for decades, was dead.

At least Sabia had been in the co-pilot's seat beside Monty. Entwistle, who had spent the previous decade as a senior manager in Britain's telecom sector, was a complete outsider when he took the job in 2000. Telus's old bosses had botched a merger with BC Tel. Then just a few months after Entwistle joined the company, the telecom industry tanked. Both companies were burdened with monopoly era mentalities and huge bureaucracies, but Entwistle went much further in whipping his company into shape. He slashed nearly 25 per cent of Telus's workforce and waged a bitter war against its unions. The result was a more efficient and nimble company.

In the midst of the chaos, Entwistle made a bold bet that has since paid off huge. He borrowed heavily and snapped up wireless provider Clearnet for $6.6 billion, arguing that growing demand for cellphones would more than make up for the price tag. Analysts and investors panned the deal at the time. Telus stock, which had traded at $41 when Entwistle was hired, collapsed to $5 by 2002. Yet today the high-growth wireless business generates 44 per cent of Telus's revenue. If Telus had managed to snag Microcell, as Entwistle so desperately wanted, that figure would likely be much higher. Bell Mobility, by contrast, generates just 20 per cent of BCE's business. It's not that Sabia never cut any cheques for acquisitions. He did. They were just piecemeal and mostly harmless.

Not that the measure of a CEO should be solely the size of his acquisitions. That's the type of thinking that got Monty into trouble in the first place. But even when the question arose of converting the two phone companies into income trusts, Entwistle led the way. At the height of the income trust boom, companies of all stripes were adopting the structure, which allowed them to reduce their taxable income by distributing it to unit holders. Phone companies, especially BCE, were seen as ideal candidates because their old land line businesses pumped out a reasonably steady stream of cash. BCE investors who were tired of the company's underperforming share price began to call for it to become a trust. Sabia steadfastly refused, saying the company needed to remain flexible in order to grow. Then last September, Entwistle unveiled Telus's plan to convert to a trust. One month later Sabia followed suit. Of course, in the end, Ottawa balked at the prospect of losing so much tax revenue and tightened trust rules, effectively killing both conversions.

The episode sealed BCE's fate. Devoid of a tangible growth strategy, and with the income trust route now blocked, investors began to push Sabia to sell off the company. With each day it seemed a new bidder emerged, including most major Canadian pension funds, several big U.S. private equity investors and Toronto's buyout firm Onex. Entwistle was there, too, dreaming now of a national phone carrier that could take on the cable companies and much larger international competitors, though it's not clear Ottawa would have allowed such a merger on competitive grounds. But the bidders bitterly complained Sabia was meddling in the negotiations and that BCE's board was needlessly rushing the process. Just minutes after the bidding closed, Telus announced it had pulled out of the race, citing "inadequacies of BCE's bid process." Even though Teachers won the auction, the fund's CEO Claude Lamoureux blasted the process, and the role of BCE management. "From my point of view, the board should have taken charge more quickly," he told a Quebec newspaper. "I don't think it's up to management to approach people to invite them into the race."

It's still not clear what the new owners, Teachers, along with U.S.-based Providence Partners and Madison Dearborn Partners, will do now that they've won the prize. A privately owned BCE will face many of the same acute problems that it does now. "They've taken on a big second mortgage on the company, at a time when they have to spend heavily on infrastructure in order to survive," says telecom analyst Ian Angus. Lamoureux has said all options are on the table, including breaking up BCE and selling it off piece by piece.

Sabia isn't expected to stick around for long after the takeover deal closes. For one thing, he stands to make a killing as a result of the sale. With the value of his deferred share units, and other bonuses, it's expected he'll walk away with as much as $30 million. And Teachers has indicated it may replace Sabia's management team with its own. "We won't throw anybody out tomorrow morning," said Lamoureux, "but we're making no promises."

Could anyone have saved BCE? It's a question that will ring long after BCE has disappeared from the Toronto Stock Exchange. Many of the analysts who complained about Sabia's inaction for five years still grudgingly give him credit for pulling the company from the fire. And they suggest BCE's problems were so deeply entrenched, the technological challenge so hopeless, that the outcome was inevitable.

Perhaps, but Sabia did his part to hasten the process by failing to present an attractive alternative. Once, when Sabia was explaining his approach to guiding BCE, he told a reporter: "There are no silver bullet answers in business, usually they glitter more than the reality that lies underneath them." But without any sparkle of a vision to attract them, investors gave up and turned away. *R.I.P. BCE*.