

David Margolese's radio play

Can the man who dreamed up cellular communications make people pay for radio? Margolese thinks he can, and he has believers

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In the early 1980s, David Margolese was an enterprising university dropout who dreamed of the potential of cellular communications. His small Vancouver paging company, Canadian Telecom Inc., was the germ of what became the national cellular telephone service known today as **Rogers Cantel Mobile Communications Inc.**

Now, he is close to realizing his second dream: launching an advertisement-free, satellite-based pay-radio service for cars that he believes will do for drivers what cable television did for couch potatoes.

The 40-year-old Margolese, who divides his time between Toronto and New York, does not dream small. It took him seven years just to secure a national licence for his CD Radio Inc. service from the U.S. Federal Communications Commission. So far, he has raised US\$500 million to fund his efforts. Much of that money has gone toward buying the licence, building two new satellites and developing the adaptor sets that subscribers to the service will have to purchase.

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lite TV services like EchoStar and DirecTV. The following year, CD Radio received a waiver from the FCC to begin building satellites, even though it did not yet have a licence.

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He is in the process of leasing 100,000 square feet in Rockefeller Center for what he calls "a super studio" and plans to hire a staff of 130 programmers and marketers. By the end of next year, CD Radio aims to launch a 50-channel service that will beam directly to "toonie"-sized satellite dishes stuck on the windshields of cars, trucks and Winnebagos.

He is in discussions with various car stereo makers to incorporate receiver chips into their products and says he is close to announcing which manufacturers will be making CD Radio adaptors that will retail for US\$199 apiece. The plan is to charge US\$10 a month for the service.

He calls CD Radio "the country's largest broadcaster. We'll put 50 new radio stations into every market in the U.S."

Of course, it won't be known whether Margolese's vision of pay-radio will be a success until it rolls out in the latter part of 1999. But his efforts so far have attracted some powerful and interesting backers: one of the company's original investors is controversial mining promoter Robert Friedland; his shares were transferred to his wife Darlene, who is listed as CD Radio's biggest shareholder with 22.5% of its stock.

Loral Space & Communications Ltd., the maker of CD Radio's satellites, has 15.2%, roughly the same stake as Margolese; and Robertson Stephens & Co., the San Francisco investment bank that specializes in technology, owns 11.7%.

CD Radio stock (CDRD/NASDAQ) has risen from as low as US\$3 in late 1995 to US\$25½ last October. This week it was trading at around US\$16.

Prominent Vancouver lawyer David Huberman, now vice-chairman of Lions Gate Entertainment Corp., has known Margolese since he was 13. "He was a very bright kid who dropped out of university," says Huberman. "It was just not challenging enough to him."

When he first touted the pay-radio concept, "I thought he was slightly off the wall," says Huberman. "But he persisted. He's really a genius and, more importantly, he's a visionary."

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In the early days of Cantel, Margolese folded his plans for a cellular licence in with a more ambitious effort headed by entrepreneur Mark Belzberg. It was Belzberg who brought in Telemedia Inc. and Rogers Communications Inc. as partners to launch the service. Rogers eventually bought out all the partners; Margolese says he ended up with a small passive stake in Cantel that was sold in 1989, along with his paging company.

Reading in trade publications, Margolese became fascinated by the concept for CD Radio. He sought out Robert Briskman, a veteran satellite engineering executive who pioneered the concept for operating a digital radio service on a frequency known as the S-Band. Briskman, now 65, is CD Radio's executive vice-president of engineering and operations.

Cable operators Time Warner Inc. and Tele-Communications Inc. have bankrolled similar music services that could be delivered over cable into homes. (In Canada, Shaw Communications Inc. markets the TCI-controlled service under the name DMX, short for Digital Music Express.) But the cable-based systems, while also offering 30 ad-free channels a month for \$10 or less, have not taken off.

"Right idea, wrong market," says Margolese. He notes 40% of radio listening takes place in cars. Nonetheless, the cable-based services have penetration of about 2.5% of the homes they are available in. "If we get 2.5% of the automotive market, that's significant."

Indeed, on paper, CD Radio's potential is huge. There are 174 million private vehicles in the U.S. equipped with CDs or cassette players, making them possible CD Radio customers. (And that's not counting the five million stereo systems purchased from audio shops each year at an average price of US\$600 each.)

Margolese's business plan calls for CD Radio to turn a profit on just one million sub-

scribers, or a market penetration of just over half of 1%.

Thomas Watts, an analyst at Merrill Lynch & Co., has a 12- to 18-month price target of US\$34 on the stock "for risk-tolerant investors." The only analysts who follow CD Radio stock, including Merrill, were involved in its underwriting. Watts' bullish view is based on his projection of earnings in 2003 of US\$100 million, or US\$6 a share. He gets to that number by forecasting 5.6 million subscribers representing a 2.8% penetration of the market.

He ups his estimate to 4.7% penetration in 2005, which amounts to revenue of US\$1.1 billion and net income of US\$368 million (US\$20.47).

These were the kinds of figures Margolese had in his head when he set off on his quest. In 1990, he started the company with about

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US\$1 million of his own money and filed its first licence application. Opposition from the National Association of Broadcasters and rival groups would drag the licensing process out for seven costly, frustrating years. Another early investor and former board member is lawyer Charles Dalfen, a former vice-chairman of the Canadian Radio-television & Telecommunications Commission. Margolese, he says, "fought so many obstacles to get to where he is today."

In the intervening years, Margolese also founded a consortium with AT&T Corp. and Hong Kong conglomerate Hutchison Whampoa Ltd. that was unsuccessful in bidding for Israel's national cellular licence in 1993.

Having raised about US\$10 million from private placements, CD Radio went public in 1994 with the help of Toronto's First Marathon Securities Inc. The speculative offering was aided by the surging stock market and the success of new direct broadcast satel-

lite TV services like EchoStar and DirecTV. The following year, CD Radio received a waiver from the FCC to begin building satellites, even though it did not yet have a licence.

Last April, it finally secured its licence, paying US\$83 million. Its only competitor, American Mobile Radio Corp., acquired a licence for US\$89 million. AMRC is a subsidiary of American Mobile Satellite Corp. (SKYC/NASDAQ), which counts giants AT&T and General Motors Corp. — which also owns DirecTV — among its backers.

A private company backed by the Saudi royal family, WorldSpace Corp. owns 20% of AMRC and has options for control. AMRC president Lon Levin says WorldSpace is launching a worldwide digital satellite service this year using three satellites, and is providing valuable technology to AMRC. He rejects Margolese's claim AMRC is about 11 months behind CD Radio in launching its service.

"It's way too early to tell who's behind whom," he says, noting schedules can't be set until both satellites each service is using are launched and tested.

Despite being rivals, he says the two companies will probably work together to create a standard technology for the US\$199 adaptor sets for cars. AMRC also has a slightly different strategy in that it is targeting home listeners and will have some advertising on its channels. "The good news," says Levin, "is the market is so big, I think we're both going to be successful."

Margolese's immediate task is building the infrastructure to turn his dream into a reality. He estimates another US\$200 million will have to be raised to fund operations until the end of 1999. A recent CD Radio prospectus highlights possible delays, including satellite launch dates and a reliance on "unproven applications of technology." For Margolese, there is little doubt this vision is going to succeed, just as Cantel did. Only this time, he intends to stay on board as chief executive. "This is my dream. This is my baby."

Eight years into his effort, he is ready to take on all the skeptics who wonder why anyone would pay for something they currently get free. He quotes Marshall McLuhan, who once said you "drive into the future looking into the rear-view mirror." That's fine with Margolese, just so long as CD Radio is playing in the background.

