



## With Verizon Fears Priced In, Telecoms Are Starting to Look Attractive

### Description

As part of our “Ask a Fool” series here at Fool.ca, we open up our electronic mailbag and answer burning questions from our followers.

Yesterday, a reader asked: “**Rogers Communications** ([TSX: RCI.B](#)) in April of this year was in the \$50 range, and by mid-April it started to fall. I’ve been looking into this stock but I’m unable to see the reason for the drop. Any thoughts on why?”

As Foolish investors, we generally don’t concern ourselves with short-term share price movements or squiggly lines on a chart. But the move in Rogers has been so big, with the stock down 20% since April, that it’s important to investigate — just in case there’s a new development critical to our investment thesis.

And that’s definitely the case with Rogers.

#### **Two reasons for the sudden sell-off**

First, dividend-paying stocks are no longer in fashion. Owning risky equities to generate income looks unattractive as interest rates start to rise. Notably, telecom stocks aren’t the only names in the doghouse. Since the start of April the S&P/TSX Capped REIT Index and the S&P/TSX Capped Utilities Index, industries that form the foundation of many income portfolios, have fallen 14% and 10%, respectively.

Second, the Canadian telecom landscape is changing. Ottawa is seeking to increase competition in the wireless industry with the goal of having four competitors in every major market across the country. To achieve this, the government relaxed its rules over foreign ownership last year, allowing foreign takeovers of telecom companies with less than 10% of total market share.

And [it looks like someone might take Ottawa up on that offer](#). In June, **Verizon's** ([NYSE: VZ](#)) Chief Financial Officer Fran Shammo confirmed that the American giant is looking to dip its toe into the Canadian telecom market. Such a venture would upset the Canadian wireless industry, which has traditionally been characterized as an oligopoly among the Big 3 telecom companies: **BCE** ([TSX: BCE](#)), **Telus** ([TSX: T](#)), and Rogers.

This is scary news for telecom investors. Verizon is a \$134 billion giant — it's more than twice the size of BCE, Telus, and Rogers *combined*. If Verizon moves in, it has the muscle to severely undercut incumbent players.

And even though it has yet to be confirmed, Verizon has already had an impact on the margins of Canadian telecom companies. This summer, the Big 3 [debuted new household data sharing plans](#) attempting to match Verizon's prices before it entered the market. While this is a big win for consumers, it's bad news for shareholders.

### **Buy, sell, or hold?**

Nonetheless, the outlook for Rogers and the other Canadian telecom stocks is surprisingly positive.

Since June, investors have been leery of the industry, even though the threat from Verizon appears to be waning. As the *Globe and Mail* [reported](#) earlier this month, Verizon is putting off a potential acquisition of smaller carriers and may only participate in the federal government's January auction for wireless spectrum. Additionally, last week, **Moody's** [issued an encouraging report](#) for established companies, noting that any industry newcomer would have to invest billions of dollars in new infrastructure. Verizon, or any other entrant for that matter, might not be able to get costs low enough to spark a price war.

So with the market pricing in the worst-case scenario — and with upside surprises possible — Canadian telecom names look enticing to me at these levels.

### **Foolish bottom line**

Investors are worried that the days of fat profit margins at Canada's Big 3 telecom companies are coming to an end. The industry's wide moat, a competitive advantage protecting it from rivals, could be eroded.

But given that this story has probably been baked into share prices already, the sector is starting to look like an attractive investment opportunity.

Speaking of attractive opportunities, The Motley Fool Canada has put together a special FREE report detailing "[A Top Canadian Small Cap for 2013 — and Beyond](#)." To see the name of this stock, download your free copy of the report by [clicking here](#).

*Robert Baillieul does not own shares of any companies mentioned.*

### **CATEGORY**

1. Investing

### **TICKERS GLOBAL**

1. NYSE:VZ (Verizon Communications Inc.)
2. TSX:BCE (BCE Inc.)
3. TSX:RCI.B (Rogers Communications Inc.)
4. TSX:T (TELUS)

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