Does Recent Market Weakness Make Manitoba Telecom Services Inc. a Value Investment?

Description

With the **S&P TSX Composite Index** hitting new highs in late August of this year and still appearing overvalued despite dropping 4% since, it is becoming increasingly difficult to find value investment opportunities. But I believe one company stands out as being unfairly valued: Canada's fifth-largest telco, **Manitoba Telecom Services Inc.** (TSX: MBT).

Why is it unfairly valued by the market?

Over recent months, the telco industry as a whole has seen share prices lag with the market due to concerns about a weaker-than-expected economy and growing signs of macro instability. But Manitoba Telecom now appears oversold and is trading at some attractive valuation metrics, with an enterprise value of seven times EBITDA (a measure of core profitability) and price-to-book ratio of 2.

These as can be seen, are lower than Canada's four largest telcos and I believe makes Manitoba an attractive proposition.

Company	Enterprise Value	EV to EBITDA	Price to Book
Manitoba Telecom Services Inc.	$3B	7	2
BCE Inc. (TSX: BCE)(NYSE: BCE)	$56B	8	3
Rogers Communications Inc. (TSX: RCI.B)(NYSE: RCI)	$37B	7	4
Telus Corp. (TSX: T)(NYSE: TU)	$33B	9	3
Shaw Communications Inc. (TSX: SJR.B)(NYSE: SJR)	$17B	8	3

Source data: Company filings.

The key driver of Manitoba Telecom's softer share price is the market's perception that it is a far riskier investment because of the company's size and failure to meet earnings expectations for the second quarter of 2014. But I believe this assessment of risk to be overblown and here's why.

Has a solid underlying business

The company holds the dominant telecommunications franchise in its core market of Manitoba and continues to focus on expanding its national network. It currently has nearly 2 million customers in Canada and its national fibre optic network spans more than 30,000 kilometres.

It is the only national telecommunications provider focused exclusively on business telecommunications market, through its Allstream business. This business segment provides a nationwide high-performance IP fiber optic network to help businesses of all sizes unify the many ways they connect. This network has an impressive footprint, connecting 3,144 buildings with nearly 600,000 customer connections Canada-wide.

But the company has been seeking a suitor to acquire Allstream for some time as a means of reducing legacy risks associated with obsolete technology and services as well as its pension scheme. The last was an Egyptian company but the deal fell through with the sale blocked by the government.

Manitoba Telecom continues to focus on revenue growth by boosting its network reach, expanding its wireless network, and growing its data centre to become a leading IT services provider. It is also focused on reducing costs and more efficiently utilizing capital in order to boost margins and profitability. This is already yielding solid results, with operations expenses for the second quarter down 1.7% year over year and EBITDA for the same period spiking a healthy 8% year over year.

There is also growing speculation that Canada's telecommunications industry is ripe for another round of consolidation and Manitoba Telecom would be a key target, especially if it divests itself of Allstream. The primary suitors would likely be BCE or Telus, with Manitoba Telecom generating significant synergies for both companies. This would be a boon for shareholders, where more than likely there would be a significant takeover premium.

Pays one of the best dividends in its sector

Another appealing aspect of Manitoba Telecom is its juicy dividend yield of 5.9%, which is one of the highest in the industry — superior to BCE's 5%, Rogers' 4.4%, and Shaw's and Telus' 4% yields.

Each of these characteristics underscores the strength of Manitoba Telecom's business and future growth prospects and highlights that it is currently undervalued by the market. With such a tasty dividend yield, investors will continue to be well rewarded until the market recognizes its intrinsic value.

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Author
mattdsmith