Manitoba Telecom Services Inc. Is Downgraded: Is This a Signal to Sell?

Description

Regional telecommunications company **Manitoba Telecom Services Inc.** (TSX:MBT) has been downgraded over fears that it is unable to meet the funding requirements for its pension plan. This puts the company in a position where it may be forced to issue equity or raise debt to meet these funding needs, or even cuts its dividend to boost cash flow and preserve its balance sheet.

So what?

Currently, Manitoba Telecom's employee benefit plan has a solvency deficit of $206 million and there is growing pressure on the company to implement a strategy to remedy this deficit. The company already has a pile of debt totalling $873 million and net debt of 2.2 times cash flow, indicating it is heavily leveraged.

Of greater concern is cash flow, and earnings growth remains relatively flat, indicating that any increase in debt will increase leverage, negatively impacting Manitoba Telecom's financial performance.

Its financial outlook remains poor with EBITDA falling as it battles legacy revenue declines from its Allstream business, which it hasn't been able to sell despite trying to do so for some time. Wireless revenues are also declining despite the volume of wireless customers growing, primarily because of other carriers transitioning customers from Manitoba's legacy CDMA network to their own networks. This is causing average revenue per unit (ARPU) to fall. For the third quarter 2014 wireless ARPU was $60.21 or a 3% drop compared to the same period in 2013.

Manitoba Telecom's wireless churn rates are also increasing, highlighting the competitive environment in which it operates and the dominance of Canada's largest wireless carriers **BCE Inc.**, **Rogers Communications Inc.**, and **Telus Corp.**.

This certainly doesn't bode well for Manitoba Telecom's cash flow or earnings growth, thereby increasing the negative impact any increase in debt will have on the company. Furthermore, issuing equity could have the impact of diluting existing shareholders who are already suffering with Manitoba Telecom's share price plunging 15% over the last year.

Now what?

It is easy to understand why the outlook for Manitoba Telecom has been downgraded. I believe the ongoing issues associated with funding its pension plan make it an unappealing investment. For those investors seeking exposure to Canada's telecommunications industry, BCE Inc. is my preferred choice and a superior opportunity to Manitoba Telecom.

This is particularly the case when BCE's wide economic moat and commitment to rewarding investors through regular dividend hikes is considered. For the last six straight years BCE has raised its dividend, whereas Manitoba Telecom's dividend has remained unchanged since slashing it by 35% in 2010.

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