BCE Inc.: Why This Dividend Stock May Reach $80 in 5 Years

Description

The Bank of Canada cut its benchmark interest rate from 0.75% to 0.5% on Wednesday, responding to what's been a very poor 2015 for the Canadian economy. Its decision should generally provide a boost, but will impact different stocks in different ways.

BCE Inc. (TSX:BCE)(NYSE:BCE) should be one of the stocks that will benefit most. We take a look at why below.

Lower debt costs

Canada's Big Three telecommunications providers operate in a very cozy industry, one characterized by subscription-based pricing, limited competition, and high barriers to entry. That makes revenue especially smooth, and BCE is no exception. Over the last three years, its revenue growth rate has fallen between 2.1% and 3.1% each year. This tends to make earnings smooth as well.

And because earnings are so smooth, BCE can afford to hold lots of debt—as of the end of last quarter, its debt load stood at a cool $23 billion. So, if the company were able to reduce its borrowing costs by even 0.25%, that equates to an extra $60 million per year in pre-tax income.

A more attractive dividend

BCE pays out practically all of its net income to shareholders and, as a result, has a juicy 4.7% dividend yield. To put this in perspective, this puts the company in the top 10 among **S&P/TSX 60**-listed companies. And most of the other top yields are from very risky companies.

This is where BCE shareholders can rejoice. Because interest rates are now that much lower, investors will struggle to find yield. Bonds will pay less, as will bank GICs. This will make dividends such as BCE's that much more attractive.

To put this in perspective, let's say that investors are willing to accept a 4% yield from BCE's shares. All of a sudden, BCE's stock price would jump to $65, or nearly 20% above the current stock price.

It gets even better. Even though Canada is in recession, the demand for telecommunications services—especially mobile data—continues to increase. This means BCE's dividend could see further increases down the road.

To illustrate what this means for the stock price, let's assume that BCE's dividend increases by 5% per year (it's increased by 7% per year in the last five years). That would make the company's dividend $0.83 per quarter in five years. If we assume investors are willing to accept a 4% yield, then that equates to an $83 stock, or roughly 50% above today's price. That's not a bad return, especially while collecting such a strong dividend.

In fact, there's an argument that all dividend stocks could benefit in the same way. The key is finding solid dividends that are unlikely to be cut.

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