Is New Technology About to Hit Canada's Telecoms Hard?

Description

Any investor in Canada's telecoms should be paying close attention to **Alphabet Inc.** (NASDAQ:GOOG)(NASDAQ:GOOGL).

The company began getting its feet wet in the telecom space a few years ago, bringing high-speed Internet to a few select cities in the United States. Systems are now operational in cities like San Antonio, Kansas City, Salt Lake City, and Atlanta. Google's Fiber offering is faster than current offerings, includes an option for television and home phone, and comes in at a price comparable to the packages offered from existing providers.

One issue has been the $300 construction payment charged by Alphabet. The company does let customers pay for it in installments over the first year, but that's still a steep price to pay.

This may be changing. The company is currently testing a fully wireless version of its broadband technology. If it finds a way to perfect this system, it'll pave the way for Alphabet to easily and cheaply enter just about any market it wants. Cutting prices at that point in an attempt to gain market share is the next logical move. Consumers fed up with high prices and onerous contracts will be lining up to make the switch.

Right now, Google Fiber is only in the United States, and only in a few markets. But with Canada's government–and consumers–crying out for more competition in the telecom space, it sure seems like our country would be a logical expansion target.

Just how big of a threat would this be to Canada's incumbent telecoms?

The bear case

The telecom sector has four basic sources of revenue. Companies charge for wireless, cable, Internet, and traditional landline phones. Two of those sources–landlines and cable TV–are facing huge structural problems.

There's really only one company in Canada growing revenues from cable TV, and that's **Telus Corporation**

(TSX:T)(NYSE:TU). Telus is gaining share in the sector by giving away freebies for customers who sign up for contracts and by expanding its network. Still, most of its new customers are just stolen from competitors like **Shaw Communications Inc.** (TSX:SJR.B)(NYSE:SJR). Overall, the cable TV industry is slowly shrinking.

That leaves just two segments that are really doing well: Internet and wireless. Internet has become something people can't live without. As more people move towards streaming more media online, demand for higher speeds will follow. That's good for the incumbents, provided somebody doesn't show up with disruptive new technology.

Say Google does enter Canada with a Fiber offering. Suddenly, Canada's telecoms will be facing big headwinds in three of four areas of their businesses. With many of these companies trading at valuations of between 18 and 20 times earnings, I envision a scenario where they only demand between 10 and 12 times earnings. In other words, the market will start pricing telecoms as terminal businesses.

The bull case

I'm not sure reality is quite as bleak as we fear.

Canada's telecoms are huge operators with millions of happy customers. Even if Google comes to Canada and undercuts prices, it's not terribly difficult for incumbent operators to match. After all, their networks are already in place.

Wireless could be affected by a huge WiFi network covering a whole city. Why spring for wireless data when there's WiFi everywhere? But it will be difficult for a Fiber network to cover Canada's vast empty spaces. Will customers be okay with that limitation? Or will they just bite the bullet and continue to pay for wireless data?

And finally, we have to remember the technology is still currently in the testing stage. It could be years before these wireless networks become a reality in the U.S., never mind Canada. For instance, I've been hearing plenty of stuff about electric cars for a while now, yet 99.9% of the vehicles I see on the road run on gasoline or diesel.

The bottom line? Investors should pay attention to this upcoming trend, but at this point, the telecoms should be okay. The issue is whether or not they'll be safe five years from now.

CATEGORY

1. Investing
2. Tech Stocks

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1. Editor's Choice

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2. NASDAQ:GOOGL (Alphabet Inc.)

3. NYSE:SJR (Shaw Communications Inc.)
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