3 Reasons to Be Bearish on Telus Corporation

Description

I'm generally bullish on **Telus Corporation** (TSX:T)(NYSE:TU).

I think there's a lot to like about the company, including its pricing power, the steadily growing dividend, and its focus on customer service. Telus shares also trade at a reasonable valuation, and the company has been aggressive with buying back shares, decreasing the float by more than 60 million shares since the end of 2012.

But there are reasons why the company might not be as secure as we all think. Here are three reasons why Telus shares could end up being a disappointment over the long term.

Increased competition

When **Shaw Communications Inc.** (TSX:SJR.B)(NYSE:SJR) bought Wind Mobile in 2015, its shares sank immediately on the news. Investors crunched the numbers, and it was obvious Wind wasn't nearly as profitable as other parts of the company. Shaw traded near-term profits for long-term growth.

Wind uses a simple strategy to gain market share: it undercuts the competition. Customers can get wireless plans that include unlimited talk and text as well as ample amounts of data for under $40 per month. None of Wind's major competitors offer anything that cheap.

Wind currently has operations in Vancouver, Calgary, Edmonton, and the Toronto area: places where Telus does pretty well. As Shaw pumps more money into Wind and it gains market share, it'll likely be at Telus's expense.

The obvious way to counter that is to lower prices. That may defend market share, but investors won't like the decreased earnings.

Foreign competition

The federal government would love more competition in the wireless space. The Conservative government was particularly vocal about this, essentially rolling out the red carpet for any foreign wireless companies looking to expand into Canada.

Although nothing looks imminent, investors have to remind themselves what happened back in 2013, when **Verizon** thought about expanding northward. Shares of the incumbents fell some 15% before recovering.

Wireless has the potential to disrupt the home internet market as well. **Alphabet Inc.** (NASDAQ:GOOG)(NASDAQ:GOOGL) bought Webpass in June, a company that provides true wireless internet to offices and apartments in a handful of U.S. cities.

Webpass uses point-to-point wireless technology, which eliminates the expense of having to lay physical fiber up to someone's property. If the technology lives up to its promise, it could make it a whole lot easier and cheaper for new competition to offer internet to our homes.

Slowing dividend growth?

Telus continues to post solid numbers, as it both improves results and buys back more shares. This nicely gooses earnings per share, which investors really focus on.

When it comes to dividend health, however, free cash flow is the important number. Capital expenditures don't get taken off earnings, yet the money to spend on these improvements has to come from somewhere.

These capital expenditures are really eating into free cash flow. In 2015 Telus posted negative free cash flow of more than $1 billion, but that number improves to positive free cash flow of $640 million when looking at the last 12 months. Still, Telus has paid out close to $1 billion in dividends in the last year as well as buying back shares.

If a company doesn't make enough free cash flow to pay for its dividends and share buybacks, it's left with one alternative: it has to borrow the money. And Telus has been aggressively borrowing. At the end of 2012 the company owed $6.7 billion to creditors. At the end of its most recent quarter, it owed more than $12.6 billion.

In 2012 the company had $3.2 billion in operating cash flow. That number increased to $3.3 billion in the last 12 months, which isn't much of an improvement. Debt has nearly doubled in the same period. This is not a trend investors want to see.

The bottom line

Telus is still a solid company with a great dividend. I don't believe that dividend is in any danger. But investors still have to consider the company's pedestrian free cash flow, the increased threat of competition, and the increasing debt load … factors that we don't talk about very often.

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Date
2025/08/22
Date Created
2016/10/28
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