BCE Inc.: The Best and Cheapest of the Telecommunications Stocks

Description

BCE Inc. (TSX:BCE)(NYSE:BCE) is one of those companies that really fascinates me. At a market cap of $56 billion, it's the largest of the Canadian telecommunications companies. And yet, compared to **Rogers Communications Inc.** (TSX:RCI.B)(NYSE:RCI) and **Telus Corporation** (TSX:T)(NYSE:TU), it's actually far cheaper, which is confusing, since it could be argued that BCE is the top telecommunications company in the space.

Rogers carries a P/E of 36.65, which, in my opinion, makes it enormously expensive. And Telus, which is having cash flow problems, trades at a P/E of 21.92. BCE only has a P/E of 18.78 — much lower than its peers.

Let's dive into BCE's business and calculate what the company *could* trade at if it got to its competitors' valuations.

In my opinion, BCE is firing on all cylinders. It announced its Q1 results in April, and the company reported 2.2% growth in revenue, but profit dropped by 4.4% to $725 million. "Aha! That explains the valuation problem," you might say. The thing is, the drop in profit is because it completed the $3.1 billion acquisition of Manitoba Telecom Services Inc., which should offer significant growth over the coming years.

In its wireless business, BCE added 36,000 new subscribers during the quarter. More importantly, it increased its average revenue per user by 4.2% to $65.66. On the internet side, BCE added 15,000 new subscribers; growth is slowing, but it's still consistent. And finally, its IPTV division added 22,000 customers. Where organic growth is slowing, BCE's Manitoba acquisition is giving the company a nice boost in growth.

The acquisition adds 229,000 internet subscribers, 108,000 IPTV subscribers, 477,000 wireless subscribers, and 420,000 network access services. It is estimated that this will result in $100 million in combined pre-tax annualized opex and capex synergies, and it is immediately accretive to free cash flow. In the long term, the acquisition should help where it matters most: dividends.

Compared to all of its competitors, BCE's dividend is, by and far, the absolute best. It currently yields

4.62%, which is good for a strong $2.87 per share. This is up 5.1% thanks to a recent hike, which continues BCE's policy of dividend increases. Since the end of 2008, BCE has increased the dividend 13 times — good for a 97% increase.

This is thanks to continuously growing free cash flow, which is incredibly important for any dividend-paying company. Between Q1 2016 and Q1 2017, the dividend grew by 18% to $489 million. Year over year, cash flow is expected to increase by 5% to 10%. Like I said, this is in part because of the Manitoba acquisition.

For whatever reason, investors don't value BCE as much as its competitors. If BCE traded at Telus's P/E of 21.92, shares would trade at $72.07 per share. And if BCE traded at Rogers's P/E of 36.65, investors would be holding BCE stock valued at $120.50 per share. While I seriously doubt BCE will ever get there, the reality is quite simple: compared to its competitors, BCE is far cheaper, and it is also the better business. It earns more, has more customers, and has a stronger dividend.

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