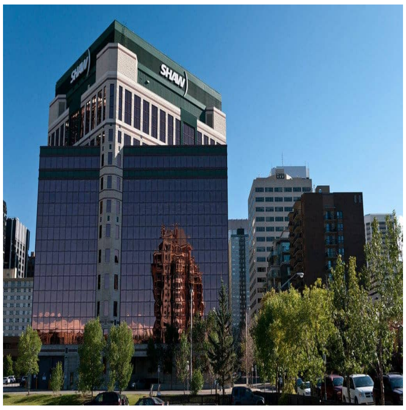

How Are the Big 3 Going to Respond to the Rising Threat of Freedom Mobile?

Description

The Big Three players, **BCE Inc.** (TSX:BCE)(NYSE:BCE), **Rogers Communications Inc.** (TSX:RCI.B)(NYSE:RCI), and **Telus Corporation** (TSX:T)(NYSE:TU), are market darlings that have delivered a great deal of capital gains to go with large dividend payouts.

Unfortunately, past performance is no guarantee of future results, especially when you consider the headwinds that the entire telecom sector is set to experience over the next few years.

Freedom Mobile, the wireless carrier of **Shaw Communications Inc.** (TSX:SJR.B)(NYSE:SJR), is a huge threat to the Big Three. I believe it has the potential to change the Canadian wireless industry forever.

Freedom's progression into the wireless scene is a story that I think many analysts have downplayed, but in time, I suspect the general public will really start to take notice, as the Big Three's subscriber-growth momentum starts to slow and potentially go negative over the next two years, as Freedom Mobile becomes a more compelling alternative for value-conscious Canadians.

How will the Big Three respond to an increase in competition?

The Big Three giants have no plans to drastically cut costs to compete with Freedom Mobile yet. They've got the edge when it comes to network quality — for now — but as tech changes and legacy infrastructure starts becoming less valuable, I suspect Freedom Mobile will eventually gain equal footing with its competitors. This is a process that's going to take at least five years, so the industry transformation is not one that's going to happen suddenly.

While Shaw management's ambitions of becoming an equal player in the wireless space (with a ~25% share of the market) may seem far-fetched at the moment, over the next decade, I certainly believe such a goal is not only reachable, but inevitable.

Eventually, it'll come to a point where the pricing pressures will become too insurmountable, and all Big Three incumbents will be forced to slash prices across all their plans. In addition, a great deal will likely be spent on jaw-dropping promotions akin to the offers our neighbours south of the border have.

Don't expect these cost cuts to come anytime soon though, as we're still in the very early stages of a telecom industry shakeup.

Could a Big Three telecom crash happen?

Possibly, but the more likely scenario would be a gradual reduction in the total returns of all the Big Three players over the next five years. A violent correction would be less likely in this scenario; instead, I believe a flatlining of shares and a slight reduction in dividend growth will be in the cards for all the Big Three players.

During the next few years, each Big Three player will likely experience a surge of spending in a rising interest rate environment. In addition, margins will gradually fall, as price reductions and promotions are beefed up to prevent subscriber losses, which may pick up momentum in the years ahead for the incumbents, which choose to sweep the dust under the rug.

Are the Big Three players doomed?

Not necessarily. Each company will deal with incoming headwinds in their own way. I suspect Rogers is best suited to fight off a rise in competition thanks to management's ability to attract and retain subscribers through its unique offerings, including *Rogers NHL Live*.

If you're an investor in the Big Three, I wouldn't panic just yet. If dividend stability is what you're after, you'll get just that; however, make sure you set realistic expectations going forward, as the telecoms head into a more challenging environment.

Stay hungry. Stay Foolish.

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