Forget About Shaw Communications Inc. (TSX:SJR.B): Buy Telus Corp (TSX:T) Instead

Description

Many Canadian investors have loaded up on Canada's top telecom names, and it's easy to see why.

Our largest telecommunications companies have massive advantages, especially on the wireless side. Consumers and governments alike would love to see a new wireless provider show up to bring prices down, but that's not likely to happen. Our incumbents are just too entrenched. A new entrant would likely bleed billions before building even a mediocre network.

This natural protection ensures our telecoms have some of the best operating margins in the world. These profits are then reinvested into the business and used to pay fantastic dividends. Just about every income investor owns a telecom or two.

When taking a look at Canada's main telecoms, it's useful to rank them from best to worst and then make your investment decision accordingly. Here's why I think **Telus Corporation** (TSX:T)(NYSE:TU) is the best in the sector and why investors should avoid **Shaw Communications Inc.** (TSX:SJR.B)(NYSE:SJR).

A tale of two strategies

Shaw has been moving away from the television business over the past few years and into wireless. It purchased Wind Mobile — which has since been rebranded as Freedom Mobile — and sold its media business to help pay for it. It has also watched thousands of cable subscribers cut the cord, although that's been offset somewhat by growth in internet.

Shaw's 2018 annual report showed this trend is still very much alive. The company lost just over 109,000 TV subscribers, a decline of approximately 4.5%. It also lost nearly 8% of its landline phone customers. However, the company made up for these declines with massive growth in the wireless division, with Freedom Mobile posted customer gains of approximately 20%.

There's just one problem. Shaw's wireline businesses are incredibly profitable, while it has been forced to cut prices to gain market share in wireless. In 2018, the company generated 18.5% operating margins in wireless, while the wireline division generated 44% operating margins.

Shaw's television and internet business is incredible, but its wireless division isn't nearly as good.

Compare that to Telus, which has done a much better job maintaining wireless margins. Through the first three quarters of 2018 — full year results aren't available yet — Telus posted operating margins in its wireless business of 43%.

Telus is also doing a better job protecting its television business. Up until 2018, Telus was steadily growing its TV subscriber base. The first three quarters of the year saw a small 1% drop in customers, which is still much better than Shaw's results. Telus also saw a 6.3% increase in internet subscribers, while Shaw saw internet users tick up less than 1%.

The price of growth

Shaw was one of Canada's top dividend growth stocks, upping the payout consistently until 2016. The dividend hasn't budged since.

There's a simple explanation for this. Shaw wants to grow its wireless division nationally so it can compete with the other providers in more than a handful of major cities. To do so will take billions in capital expenditures. Shaw will need cash to pay for this, which means that investors shouldn't expect any dividend growth for a very long time.

This is where Shaw's new focus on wireless is backfiring. It's essentially trading 40%+ operating margin revenue for revenue that's half as lucrative. This move may work out quite well in the long term, but it isn't going to lead to higher dividends in the short term.

Compare that to Telus, a dividend growth machine. It has hiked its payout twice annually since 2010, more than doubling the quarterly dividends since then. Since 2016, when Shaw paused dividend growth, Telus has raised its dividend five times, and the quarterly distribution has increased from $0.44 per share to $0.525. Look for Telus to raise its dividend again when it reports fourth-quarter earnings in a couple of weeks.

The bottom line

Shaw's move to wireless will likely work out over the long term, but it has a long way to go before coming a major player in wireless. Telus is the far better investment today. Shareholders get a comparable yield with far superior dividend growth prospects. And Telus isn't just beating Shaw in wireless, either; it's also doing a much better job protecting its wireline business.

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2. NYSE:TU (TELUS)
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