These 2 Canadian Telecoms Stocks Are Healthier Than You Think

Description

With low expected growth and so-so balance sheets being a common perception of the current state of TSX index telecoms stocks, they may not seem like the best choices for stocks to buy and hold for the long-term, especially in today's uncertain economic climate. However, the following analysis of the available data shows that two such stocks may in fact prove to be fairly sound investment choices after all.

Rogers Communications (TSX:RCI.B)(NYSE:RCI)

The projected ROE for a Canadian wireless telecoms stock over the next three years is 11%; Rogers Communications is set to beat this with an expected ROE of 23.4%, thereby representing an efficient use of shareholders' funds.

To a passive income investor, two of the most salient pieces of information for Rogers Communications stock are that it pays a dividend yield of 2.82% with an expected earnings growth of 7.9%. Getting a clear fix on its valuation is another matter, however, with a decent P/E of 17.8 times earnings let down by a P/B of 4.5 times book. Intrinsic value may therefore be better elucidated by a discount of 20% against the future cash flow value.

Though Rogers Communications carries a high comparative level of debt at 202.3% of net worth, the good news is that this percentage not only represents a reduction over the last five years, but it is also well covered by the company's operating cash flow. It had a good year, with a one-year past earnings growth of 20.3% that beats its own 4.2% five-year average almost five times over.

BCE (TSX:BCE)(NYSE:BCE)

BCE's one-year past earnings growth is lower than its five-year average, although the latter has been positive at 6.5%. A future ROE of 15.5% over the next three years beats the Canadian wireless telecoms average, though it falls below the threshold for significantly efficient use of funds.

Again, the balance sheet is an issue: BCE's debt of 118% of net worth is high, and represents a slight increase over the last five years, although it is sufficiently covered by operating cash flow. This latter point is salient, and should be taken into account when weighing up whether to buy. Other possible red flags would include more inside selling than buying in the last three months, though this has not been by a particularly large margin.

Valuation is not too dissimilar from Rogers Communications, though is slightly more favourable overall, with a P/E of 18.4 times earnings, P/B of 3.1 times book, and discount of 22% against the future cash flow value. Add to this a dividend yield of 5.56% and you have a compelling case for this well-known TSX index telecoms stock.

The bottom line

Though BCE's 8.5% expected annual growth in earnings may be rather low, it does go some way to making this a more palatable play for passive income when viewed in context with a similar outlook for Rogers Communications. Both stocks, while carrying high debt, are able to service the same while offering tempting dividends (if investors can look past low expected growth in earnings) in a fairly sturdy sector of the TSX index.

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