



Shaw Communications (TSX:SJR.B): Underdog or Overvalued?

Description

Canada's telecommunications industry is best described as an oligopoly. The [top three players](#) control an astounding 88.7% of the total wireless communications market. This stranglehold has allowed all three companies to rake in profits and hand out handsome dividends, while smaller regional players are left fighting over scraps.

A hefty chunk of those scraps is controlled by **Shaw Communications** ([TSX:SJR.B](#))([NYSE:SJR](#)), which entered the market through its acquisition of Wind Mobile in 2015. The company has spent the past few years aggressively marketing to subscribers and bolstering its network by purchasing low- and high-frequency spectrum from competitors.

According to the Canadian Radio-television and Telecommunications Commission, Shaw controls 2.8% of the wireless market in Canada through its Freedom Mobile brand. That puts it in the same league as **Quebecor**.

As Canada's fifth-largest telecoms company, Shaw strikes the perfect balance between growth opportunities and steady cash flow. While it fights for a bigger chunk of the market, it offers an attractive 4.33% dividend yield and lower debt.

Here's a closer look at what could be one of the best investment opportunities in this sector.

Fundamentals

While revenue has been steadily creeping up since 2015, net income has been sliding down. Annual sales have gone from \$4.5 billion to \$5.2 billion over this period, while net income has declined from \$842 million to \$52 million.

The problem seems to lie in the core operations, as costs of sales have been rising faster than total revenue.

Unsurprisingly, the stock has followed this downward trajectory over the past four years, plunging from \$27.3 at the start of 2015 to just above \$20.4 today — a difference of 25%.

Growth opportunities

As a whole, IBISWorld estimates the telecommunications and wireless industry will expand at a compounded annual rate of 3.4% over the next four years to 2023. Smaller players like Shaw could grow faster than this average rate if they succeed in snatching market share away from the top three players.

There are two key catalysts that are steadily changing the industry and broadening Shaw's prospects. One is the roll-out of 5G technology. If Shaw can deploy capital and stay at the forefront of this roll-out, its market share will be a lot higher by the end of the decade when 5G is the new industry standard.

Another key catalyst is the next spectrum auction. According to the ministry of Innovation, Science, and Economic Development Canada (ISED), this year's auction will involve a 43% reservation of spectrum for regional and smaller players in the market. In other words, the government is stepping in to break the oligopoly and help players like Shaw gain more market share.

Valuation

At 88% of equity, the company's debt burden isn't as much of a concern as it is for the rest of the industry. The average debt-to-equity ratio of the top three players is 153. A smaller debt burden means Shaw has more capital to deploy to shareholders and future investments.

The company also has enough of cash and cash equivalents on the book to cover dividends for the next two years. In fact, the most recent dividend was paid directly from this cash hoard because earnings were too low to cover it.

If earnings recover this year, the company's current market price would indicate a forward-price-to-earnings ratio of 18. In my opinion, that multiple is justified considering Shaw's potential for growth and dividend cover.

Bottom line

Shaw communications has had a bad year, but if earnings recover, debt remains low, and the upcoming spectrum auction gives them a chance to gain more market share, the current price could be justified.

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