Dividend Stocks Showdown: Wireless Juggernauts

Description

There's no better hunting ground for high-yield dividend stocks than Canada's telecommunications sector. Heavily concentrated at the top, the wireless service industry is awash in cash flow that more than covers the costs of infrastructure investments and technology upgrades. The rest is paid out to investors in the form of dividends.

According to a report by IBISWorld, the top five players in the telecommunications market control 94.5% of the subscriber base. The concentration is even more acute when you consider the top three players – **Telus Corporation** (TSX:T)(NYSE:TU), **Rogers Communications** (TSX:RCI.B)(NYSE:RCI), and **BCE Inc.** (TSX:BCE)(NYSE:BCE) – collectively hold 88.7% of the market.

All three players enjoy high annual revenue per user, economies of scale, and high technical barriers to entry. In other words, they're highly protected money-making machines that have delivered extraordinary dividends for shareholders.

TELUS provides a forward dividend yield of 4.5%, while Rogers and BCE provide yields of 2.75% and 5.44% respectively. The average dividend yield here is 4.2%, which is nearly two and a half times greater than the yield on a 10-year Canadian government bond.

That yield is also 50% higher than the average dividend of the **S&P/TSX Composite Index** over the past year.

With stable earnings, stable growth prospects, and high dividends, the best way to compare valuations between these wireless giants is to apply the dividend discount model (next year's dividend divided by the difference between the required rate of capital investment and the assumed rate of growth).

TELUS

Vancouver-based Telus commands 23.2% of the Canadian wireless market. The company's dividend payout ratio is currently 82.4%, which means that it pays in dividend nearly every penny it earns in net income.

Institutional investors hold a majority of the stock (58.3%). **Royal Bank** owns 7.74%, while TD Asset Management owns 3.8%. Institutional holdings are a clear green flag for any stock.

Assuming the Canadian market grows at a rate of 3.5% annually (based on IBIS World estimates) and the required rate on Telus' stock is 5.5%, the dividend discount model generates an intrinsic value of $109. In other words, TELUS trades at a 56% discount to its value.

Rogers

Rogers currently trades at $72.48, indicating a market capitalization of $37.35 billion and a dividend yield of 2.76%.

This is the lowest yielding stock from the basket of top three players. The reason for this underwhelming payout is the amount of money Rogers spends on paying off its massive debt load every year. Currently, the company has $2 in debt for every $1 in equity on its book. Consequently, the payout ratio is only 48.12%.

With its greater risk and higher debt burden, I've assumed a higher required rate of return for Rogers – 7%. Applying the same dividend discount model as before, the stock's intrinsic value works out to about $57. Rogers seems overvalued by a significant margin.

BCE

Finally, the biggest wireless company in the country also offers the most attractive dividend yield – 5.44%.

At 97.4%, the payout ratio is also much higher than its closest rivals. However, BCE has slightly better operating margins and slightly lower debt than TELUS. It also has $10 million more in cash on the books.

Applying the same required rate (5.5%) and growth rate (3.5%) assumptions as TELUS, BCE's stock could be valued around $158.5. At its current price of $59, BCE appears to be the most severely undervalued stock of the three.

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2. NYSE:RCI (Rogers Communications Inc.)
3. NYSE:RY (Royal Bank of Canada)
4. NYSE:TU (TELUS)
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