Why it’s Time Dividend Investors Parted Ways With BCE Inc. (TSX:BCE)

Description

BCE (TSX:BCE)(NYSE:BCE) had an amazing run with huge dividends, dividend growth, and capital gains. As we head into a more competitive environment that’ll see the capex bar raised, however, there are reasons to believe the best days of BCE are already in the rear-view mirror.

Of late, BCE has been spending wads of cash on 5G wireless infrastructure and rolling out fibre-to-the-home in select markets. While the move to next-gen wireless and wireline tech has been going smoothly, it’s been pretty taxing on the company’s pocketbook. With more bloated legacy infrastructure slated to depreciate, BCE is looking a lot less agile than some its smaller peers.

My negative thesis on BCE is simple. As Canada’s largest telecom, the company has the most to lose as the triopoly is gradually dissolved thanks to new competition and regulatory hurdles that’ll make it that much harder for BCE to support the magnitude of growth and total returns it had over the past decade.

The only way to grow meaningfully is through M&A, and even growth from such endeavours aren’t going to be impressive; if I had to guess, robust takeover targets would cost a premium, and they really won’t do much given the telecom behemoth’s sheer size. Such a growth acquisition is akin to an extra oar for an aircraft carrier. It just won’t make that much of a difference!

Still, management is determined to find M&A opportunities to achieve 5% in free cash flow growth to support modest annual dividend hikes of around the same magnitude. A 5.2% dividend yield with a 5% dividend CAGR sounds fantastic on paper, but when you weigh the competitive headwinds that are on the horizon, I’m highly skeptical of BCE’s growth trajectory and its overly ambitious (albeit seemingly realistic) goal of growing its free cash flow and thus its dividend by 5%.

Make no mistake. BCE is still a very high-quality provider of telecom services, and it'll continue to be a gold standard in select markets. Unfortunately, being a top-tier telecom is no longer a guarantee of sufficient returns in the new era of telecom that's up ahead. I've often described spending on new infrastructure as moves to "keep up with the Jones's," as every other telecom is also throwing a pretty penny at new telecom tech.

Kay Ng, my colleague here at the Motley Fool Canada, had some harsh words for BCE in a recent article: "The below-average growth will lead to fairly low returns — in my opinion, unacceptable returns. Specifically, I'm imagining a scenario in which BCE stock will experience a reversion to the mean. If so, we could see the stock fall quickly to the $53 level over the next 12 months — a drawdown of about 10.8%"

Kay and I are on the same page when it comes to BCE. It's bloated, and given the headwinds, 9-11% in total returns are starting to look like a pipe dream.

Furthermore, I think BCE's 19.6 trailing P/E is absurd given its less-than-favourable positioning. You're paying a hefty premium for low growth because of the company's reputation as a top-tier dividend stud. It's likely going to lose this status in time, however.

I'd ditch the stock to the curb now before other investors finally break up with the market darling that's in dire need of a severe expectation reset.

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