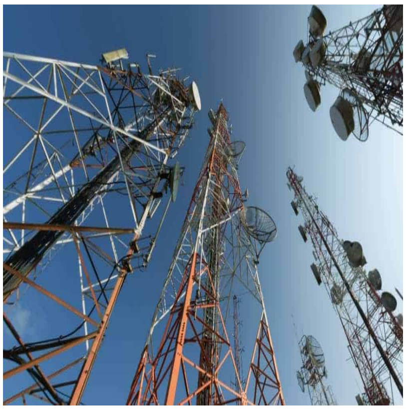

Don’t Buy Shaw Communications (TSX:SJR.B) Shares Until This Happens

Description

Shaw Communications (TSX:SJR.B)(NYSE:SJR) is at a crossroads.

The company’s expansion into the wireless space is going well, with Freedom Mobile delivering excellent growth as the service moves into new cities. Citizens of places like Lethbridge, Kamloops, and Comox can now become Freedom customers — a move that will likely save them money versus going with the traditional providers.

Combine the growth in the network with Freedom’s ability to steal customers in major cities, and the newest part of Shaw is posting some pretty stellar growth. It added some 62,000 mobile subscribers in the latest quarter alone and has watched total wireless subscriber counts increase by 10% through the first three quarters of fiscal 2019. There are now more than 1.5 million Freedom Mobile subscribers. Shaw has quietly become a force in the sector.

But it’s not all good news, however. Freedom is borrowing a trick from many other upstarts in the past, namely dropping prices to get market share. Combine that with big marketing expenses, capital costs to expand the network to new cities, and inevitable upgrades to keep up with new technology, and Shaw’s wireless division is posting just over 20% operating margins. That’s about half the profit margin enjoyed by the company’s more entrenched competition.

The legacy business

Most readers probably know Shaw because of its traditional business, which is selling cable TV, internet access, or home phone service to Canadians living in the western part of the country. This has historically been a great sector to be in, with benefits like a sticky customer base, the ability to raise prices, and solid growth as places like Alberta and Saskatchewan that benefited from an oil boom.

Unfortunately, that’s no longer the case. The legacy business has been a melting ice cube for years now, with slight gains in internet customers more than offset by big declines in both the television and home phone parts of the company.

In the first three quarters of fiscal 2019, Shaw has lost approximately 110,000 cable and satellite TV subscribers. That's a decline of approximately 4%. Home phone has actually performed worse, with a decline of approximately 5%. The only bright spot is internet subscribers, with the company adding just over 23,000 customers there so far in 2019.

The good news for Shaw shareholders is the legacy business still earns a ton of money. Operating margins for the wireline division are well north of 40%, and the company has been able to minimize the revenue losses by raising prices. Still, I'm skeptical of what the future will hold, especially when new streaming services hit the market next month.

The solution

One part of Shaw is growing like crazy, with potential to keep it going for a few more years at least. The other is slowly shrinking, and the future doesn't look good. I don't think it's a good idea to keep these two businesses under one roof. The shrinking cash cow will scare off growth investors, and the crummy margins of the wireless business will cause value or dividend investors to stay away.

The solution is simple: Shaw needs to split into two.

That way growth investors can put their money to work in a pure-play wireless operator, one whose results won't be weighed down by a failing legacy business. And the older part of Shaw can sit back, relax, and collect big cash flows from a very mature business. It can then pay out huge dividends to yield-hungry Canadian retirees.

Shaw today will never please everyone. So, the only logical solution is to split the company into two separate parts. Because I think this is an unlikely path, I'm going to avoid the stock in my own portfolio.

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