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TOUGH TIMES FOR TELECOMS

By Gordon Pape, Editor and Publisher

It's not a great time to be an employee in Canada's telecom sector. Workers across the country are biting their nails as their employers axe thousands of people in a firing binge unlike any we've seen in years.

Vancouver-based Telus plans to lay off 6,000 employees, including 2,000 from Telus International, in a move that is expected to save the company $325 million a year.

Rogers Communications has already started to lay off staff following the completion of its take-over of Shaw Communications. The company has not announced a target for staff reduction, but it expects to realize $200 million in synergies in 2023, and annualized cost synergies of at least $600 million by the end of the first quarter of 2024. Those numbers have staff wondering where the axe will fall.

BCE Inc. is also laying off staff, particularly in the high-profile media division. After the surprise ousting of CTV

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news anchor Lisa LaFlamme last year, an uneasy calm set in. That ended in June when the company announced it was terminating 1,300 employees including veteran correspondents Tom Walters, Paul Workman, Joyce Napier, Glen McGregor, and Daniele Hamamdjian. CTV also closed its London and Los Angeles bureaus, leaving Washington as its only non-Canadian outpost.

These moves reflect the underlying problems of all telecom companies. By its nature, the industry carries a heavy debt load, resulting from massive infrastructure investments over the years.

That process continues to this day, with the upgrade to 5G wireless and the installation of fibre optic cables. BCE spent $5.1 billion on capital expenditures in 2022, up 5.8% from the previous year.

At the end of 2022, BCE reported net debt of $33.7 billion. Of that, $4.1 billion was short-term debt (due within one year), which was up $1.5 billion from the previous year. This portion of corporate debt would be the most vulnerable to rising interest rates. Interest expense in 2022 was over $1.1 billion.

Here's a look at the latest financial reports from the Big Three telecoms. Note that Rogers is not on our recommended list.

BCE Inc. TSX, NYSE: BCE

BUY

Originally recommended on Dec. 14/08 (#2844) at C$21.30, US$17.06. Closed Friday at C$56.78, US$42.23.

Background: BCE is Canada's largest communications company, providing a comprehensive suite of broadband, mobile, landline, and cable communication services to residential and business customers through Bell Canada and Bell Aliant.

Bell Media is the company's multimedia arm, with assets in television, radio, and digital media. Television assets include the CTV television network and many of the country's most-watched specialty channels. The company also owns the Crave streaming service.

Performance: The stock was trading at over $65 in early April but has been on a downward slide since.

Recent developments: The company has been laying off staff and took a big hit on second quarter profits as a result. The media division has seen a drop in revenue, as ad dollars bleed to US multinationals. As if that weren't enough, the rising interest rate environment has been a drag on the share price.

The latest financial results showed

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operating revenue of $6.1 billion in the second quarter, up 3.5% from $5.9 billion in the same period last year. However, earnings attributed to common shareholders fell 44.8% to $329 million ($0.37 a share), compared to $596 million ($0.66 a share) in 2022.

Free cash flow was just over $1 billion, down 23.8% from $1.3 billion a year ago. On the positive side of the ledger, the company reported 241,516 total wireless mobile phone and mobile connected device net activations, up 76.5% over last year and the best performance in 15 years.

Chief financial offer Glen LeBlanc said the results were achieved

“despite ongoing media advertising headwinds, increased competitive intensity, and a B2B sector that has not yet fully recovered from the global supply chain disruptions experienced over the past several years."

Bell Media revenue decreased by 1.9% to $805 million. Advertising revenue was down 9%, as advertiser demand and spending across all traditional media platforms remained soft due to unfavourable macroeconomic conditions. This was partly offset by strong growth in digital advertising.

The company confirmed its guidance for the rest of the year, but the ranges are very broad, reflecting corporate uncertainty of how the rest of 2023 will unfold. Revenue is expected to be up between 1% and 5%, compared to 3.1% last year. Earnings per share will decline 3%-7% (up 5% in 2022). Free cash flow will increase between 2%-10%, from 2.9% a year ago.

Dividend: The shares pay a quarterly dividend of $0.9675 ($3.87 per year) to yield 6.8% at the current price.

Outlook: As the guidance indicates, the rest of the year looks choppy. However, the strong growth in wireless services and the roll-out of Bell’s 5G network should produce better results going forward.

Action now: The share price should rebound when interest rates stabilize. Meantime, you’re being paid very handsomely to wait. Buy.

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Questions?

Our team of experts have the answers!

Send your questions to
gordonpape@hotmail.com

Selected Q&A will be published in an upcoming issue!

Telus TSX: T, NYSE: TU

Originally recommended on Nov. 13/06 (#2640) at C$6.86.

(Adjusted for March 2020 split). Closed Friday at C$23.78, US$17.70.

Background: Telus Corp. is Canada's second largest wireless telecom company after Rogers Communications Inc. Its core business includes internet and mobile phone service through the Telus and Koodo brands. It recently spun off Telus International, which provides IT and customer service. It is using that as a model to grow its healthcare and agriculture businesses with an eye to spinning them off as well.

Performance: The stock was trading at around $29 in late April but has been in a decline since, along with the rest of the sector.

Recent developments: Second quarter results showed a similar pattern to those of BCE: revenue up, profits down. Operating revenue for the three months to June 30 was $4.9 billion, up 12.8% from $4.4 billion in the same period last year. But net income attributable to common shares took a 57% nose-dive to $200 million ($0.14 a share) from $468 million ($0.34 a share) in 2022. Higher interest costs were among the main culprits in the profit decline. Telus reported financing expenses of $323 million in the quarter, a big jump from $97 million the year before.

On the positive side, the company reported 110,000 net mobile phone additions, its best second quarter since 2010.

Telus expects to incur restructuring costs of $475 million this year as it proceeds with its lay-off plans, which focus on early retirement and voluntary departure packages. The company expects the pay-off will be annual savings of $325 million.

Dividend: The shares pay a quarterly dividend of $0.3636 ($1.4544 a year) to yield 6.1% at the current price. Sharp-eyed readers will note immediately that profit is well below the dividend pay-out rate. However, there is no suggestion of a dividend cut coming.

Outlook: Telus downgraded its guidance for the rest of 2023. Operating revenue is now expected to grow between 9.5% and 11.5%, down from 11-14%. Adjusted EBITDA is forecast to increase 7-8%, a decrease from the previous range of 9.5-11%. Free cash flow will come in at around $1.5 billion. Previously, the company had expected $2 billion. The drop reflects the high restructuring costs related to the cost-cutting programs.

Action now: Buy. Like BCE, the stock is oversold.

Rogers Communications

TSX: RCI.B; NYSE: RCI

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

Background: Toronto-based Rogers is Canada's largest wireless and cable company. The company also owns the Toronto Blue Jays and their home stadium, the Rogers Centre.

Performance: The chart looks like a profile of the Rocky Mountains, but the bottom line is that the stock is trading only slightly above its level in September 2020.

Recent developments: The company posted strong second quarter results, boosted by the takeover of Calgary-based Shaw Communications, which closed on April 3.

Rogers reported revenue of just over $5 billion for the quarter, up 30% from $3.9 billion last year. Adjusted net income was $544 million ($1.02 per diluted share), a gain of 17% from $463 million ($0.86 per share) in 2022. Free cash flow was $476 million, up from $344 million a year ago.

CEO Tony Staffieri said the integration with Shaw is running ahead of schedule. The acquisition brings Rogers cable telecommunications, satellite video services, and data networking to residential customers, businesses, and public-sector entities in British Columbia, Alberta, Saskatchewan, and Manitoba, greatly expanding the company's reach.

Dividend: The shares pay a quarterly dividend of $0.50 ($2 annually) to yield 3.5% at Friday's closing price in Toronto of $56.70.

Outlook: The company raised its guidance for the year for both adjusted EDITDA and free cash flow.

Action now: Winning approval of the Shaw deal was a long, tough fight but now Rogers is starting to reap the rewards. The p/e ratio is the lowest of these three telecoms, a point in its favour. But all these stocks should see their prices increase when interest rates start to trend back down.

Meantime, Rogers' dividend yield is about half of the other two. For many investors, yield is an important consideration in deciding which telecom stock to buy.

If cash flow is your priority, choose BCE or Telus over Rogers.

THE LONG, HOT SUMMER

By Glenn Rogers, Contributing Editor

It's been a long, hot summer and it's not over yet. In fact, it was the hottest July on record worldwide. Obviously, this is a calamity on many levels but our job here is to try and find which companies might benefit from these disastrous temperatures and provide opportunities for you to make some money while you are hopefully in some cool place.

Yes, lousy optics. But sometimes investing can be that way.

Obviously, companies that make the equipment that provide cooling systems stand to benefit as consumers and contractors rush to retrofit and add HVAC equipment to buildings old and new. Utilities will also benefit but that's a story for the next column. Today, I'll suggest two US companies that dominate this field, but there are several others worldwide that are worth considering.

The HVAC equipment market is expected to grow at a significant rate in the coming years, driven by factors such as global warming, urbanization, energy efficiency, and government incentives. Among the major players in this market, Trane and Carrier stand out as the leading brands in the US, with a combined market share of 38.4%. Trane and Carrier offer a wide range of products for heating, ventilation, and cooling applications, catering to residential, commercial, and industrial customers. Both brands have a strong reputation for quality, reliability, and innovation, but they also have some differences in terms of features, pricing, and customer service. In this column, I'll compare Trane and Carrier HVAC systems and explore their strengths and weaknesses in the competitive market for this equipment.

Let's begin with their financial performance and outlook. Trane Technologies PLC (NYSE: TT) has a market cap of $46.57 billion, a p/e ratio of 26.21, an EPS of $7.79, and a dividend yield of 1.47%. The stock price has increased by 46.7% in the past year and reached an all-time high of $209.17 on Aug. 7. Trane reported strong results for the second quarter, beating earnings estimates by 9% and raising its revenue and EPS guidance for the full year.

Carrier Global Corp (NYSE: CARR) has a market cap of $50.77 billion, a p/e ratio of 24.29, an EPS of $2.35, and a dividend yield of 0.98%. The stock price has increased by 64% in the past year and reached an all-time high of $60.04 on Aug. 1. Carrier Global also reported strong results for the second quarter, beating earnings estimates by 8% and raising its revenue guidance for the full year.

Both Trane and Carrier stocks showed impressive growth and resilience amid the pandemic and the recovery phase.

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However, based on their valuation metrics, Carrier seems to be slightly more undervalued than Trane at current price levels. Moreover, according to Insider Monkey, Carrier has more hedge fund interest than Trane as of the first quarter of 2023, with 54 hedge funds holding long positions in CARR versus 49 hedge funds holding long positions in TT.

Therefore, if you are looking for a better investment opportunity between Trane and Carrier stocks, you may want to consider Carrier as it appears to have more upside potential and less downside risk than Trane at this point.

Another factor that may influence your investment decision is the exposure of Trane and Carrier to different geographic regions. Both companies generate revenues from four main areas: Americas, Europe, Asia Pacific, and Middle East & Africa (MEA). The table below shows the breakdown of revenues by region for both companies in 2022:

Region	Trane	Carrier
Americas	64%	60%
Europe	18%	21%
Asia Pacific	13%	12%
MEA	5%	7%

As you can see, the companies have a similar revenue distribution by region, with the Americas being the largest market for both. However, Carrier has slightly more exposure to Europe than Trane, with 21% of its revenues coming from this region versus 18% for Trane. This means that Carrier may benefit more from the recovery and growth of the European market, which has been lagging the US due to the pandemic, energy access, and other challenges. Europe has been extremely hard hit this summer and countries like Italy are now installing HVAC systems which was extremely unusual until very recently.

Trane has more exposure to the US market, which has been leading the global recovery and growth, especially in the HVAC sector.

As you can see by the numbers, there is not a lot to choose between these two companies. I own both but I have a slight preference for Carrier.

If you are interested in investing in other HVAC-related stocks besides Trane and Carrier, you may want to consider some of the following options:

Lennox International Inc. (NYSE: LII). Lennox is a global provider of climate control solutions for residential and commercial markets, including HVAC equipment. The company has a market cap of $12.2 billion, a p/e ratio of 33.67, an EPS of $11.04, and a dividend yield of 0.94%. The stock price has increased by 32% in the past year and reached an all-time high of $382.41 on Aug. 7. According to Nasdaq, Lennox International has a strong balance sheet, solid cash flow generation, and a consistent dividend payment history.

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AAON, Inc. (NDQ: AAON). This company is a manufacturer and seller of air conditioning and heating equipment, including rooftop units, chillers, air-handling units, and heat pumps. The company has a market cap of $3.1 billion, a p/e ratio of 49.51, an EPS of $1.23, and a dividend yield of 0.55%. The stock price has increased by 17% in the past year and reached an all-time high of $107.09 on Aug. 2. According to Nasdaq, AAON has a strong growth outlook, a loyal customer base, and a robust product portfolio.

Daikin Industries Ltd. (OTC: DKILY). This is a Japanese company that is the world's largest manufacturer of air conditioners and refrigerants. Daikin offers a range of products that provide heating, cooling, ventilation, and air purification for residential, commercial, and industrial applications. Daikin also invests in research and development of energy-efficient and environmentally friendly technologies, such as hydrofluorocarbon (HFC) alternatives, heat pumps, and smart thermostats.

Johnson Controls International plc (NYSE: JCI). This is an Irish company that is a global leader in building technologies and solutions. Johnson Controls provides HVAC systems, fire and security systems, building automation and controls, and digital solutions for various sectors, such as healthcare, education, hospitality, retail, and government. Johnson Controls also focuses on sustainability and innovation, such as green buildings, smart cities, and renewable energy.

LG Electronics Inc. (OTC: LGEAF). LG is a South Korean company that is a major player in the consumer electronics and appliances market. LG offers a variety of products that can improve the indoor air quality, such as air conditioners, air purifiers, dehumidifiers, humidifiers, fans, heaters, and vacuum cleaners. LG also strives to develop innovative and eco-friendly products, such as smart appliances, artificial intelligence (AI), and OLED displays.

Samsung Electronics Co., Ltd. (OTC: SSNLF). This is another South Korean company that is a global leader in the electronics industry. Samsung offers products that can enhance the indoor air quality, such as air conditioners, air purifiers, dehumidifiers, humidifiers, fans, heaters, vacuum cleaners, and robot cleaners. Samsung also invests in advanced technologies and solutions, such as internet of things (IoT), 5G networks, cloud computing, and quantum dots.

Action now: Buy Carrier with a target price of $80. The stock closed Friday at $55.54.

Contributing editor Glenn Rogers has worked with private equity and venture groups on a variety of projects leading to successful exits for investors. Previously he held senior executive positions in both Canada and the US and is a successful investor himself. He lives with his family in southern California.

NextEra Energy NYSE: NEE

BUY

Originally recommended on Sept. 26/22 (#22235) at $82.52. Closed Friday at $68.92. (All figures in US dollars.)

Background: NextEra has been in business since 1925 and operates in segments such as electric generation, transmission and distribution, natural gas pipelines and storage, and retail electricity. Its largest holding is Florida Power and Light (FPL), America's largest electric utility, and it claims to generate more wind and solar energy than any other company in the world.

Performance: We recommended the stock last September when it was trading at $82.52. It has since sold off along with the rest of the sector, as utilities tend to slump in a rising interest rate environment.

Recent developments: The company released second quarter results in July. Adjusted net income attributable to shareholders was $1.8 billion ($0.88 per share), compared to $1.6 billion ($0.81 per share) in the second quarter of 2022. That's an 8.6% gain in earnings per share.

Dividend: The quarterly dividend is $0.4675 ($1.87 a year), for a yield of 2.7%.

Outlook: NEE has consistently delivered strong earnings growth and dividend increases for its shareholders. For 2023 and 2024 the company expects adjusted earnings per share to be in the ranges of $2.98 to $3.13 and $3.23 to $3.43, respectively.

For 2025 and 2026, NextEra Energy expects growth of 6% to 8%, based on the 2024 adjusted earnings per share range. This translates to a range of $3.45 to $3.70 for 2025 and $3.63 to $4.00 for 2026.

The company also expects to grow its dividends per share at a roughly 10% rate per year through at least 2024, off a 2022 base.

Action now: Buy.

Ross Stores NDQ: ROST

HOLD

Originally recommended on Nov. 28/22 (#22242) at $115.94. Closed Friday at $113.39. (All figures in US dollars.)

Background: Ross Stores, Inc. is a leading off-price retailer that operates over 1,800 stores under the Ross Dress for Less and dd's Discounts brands.

Performance: We recommended this stock last November when it was trading at $115.94. It then traded up to $122.45 before settling back and has been trading sideways ever since.

Recent developments: Ross was resilient during the pandemic and has recovered strongly from the temporary store closures in 2020. For the fourth quarter of the 2022 fiscal year (ending Jan. 28, 2023) the company reported a 26% increase in earnings per share to $1.31 on net income of $447 million.

For the full year, earnings per share were $4.38 on net income of $1.5 billion. That compared to $4.87 per share on net earnings of $1.7 billion in 2021. Sales for 2022 were $18.7 billion, versus $18.9 billion in fiscal 2021, with comparable store sales down 4%, versus a 13% increase in the prior year.

CEO Barbara Rentler was pleased with the results. "During a very competitive holiday season, fourth quarter sales and earnings exceeded our guidance due to customers' positive response to our improved assortments and stronger value offerings," she said.

"Fourth quarter operating margin was 10.7% compared to 9.8% in 2021. This improvement was mainly driven by lower freight and incentive costs."

For the latest quarter, the company reported earnings per share of $1.09 on net earnings of $371 million. These results compare to earnings per share of $0.97 on net income of $338 million for the 13 weeks ended April 30, 2022. Sales were $4.5 billion, up from $4.3 billion in the prior year period. Comparable store sales were up 1%.

Dividend and buybacks: The company increased the quarterly dividend by 8% to $0.335 per share ($1.34 per year) effective with the March payment. The stock yields 1.2%.

Ross also maintains an aggressive share buyback program. During fiscal 2022, the company repurchased a total of 10.3 million shares of common stock, for a cost of $950 million. The purchases were made pursuant to a two-year $1.9 billion program announced in March 2022. Ross expects to use the remaining $950 million for repurchases this year.

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The TJX Companies, Inc. NYSE: TJX

Originally recommended on Nov. 28/22 (#22242) at $81.03. Closed Friday at $85.89. (All figures in US dollars.)

HOLD

Background: TJX is a leading off-price retailer that operates over 4,600 stores under various banners such as T.J. Maxx, Marshalls, HomeGoods, Sierra, Winners, HomeSense, and T.K. Maxx. There are Marshalls, Winners, and HomeSense stores in several Canadian cities.

Performance: We recommended the stock last November at $81.03. It closed Friday at $85.89 for a small gain of 6%.

Recent developments: Like Ross, TJX has bounced back from the pandemic-induced disruptions and has delivered above-plan results in 2023.

The company reported a 10.3% pretax profit margin and a 3% increase in comparable store sales in the first quarter of the year. Net sales were up marginally to $11.8 billion from $11.4 billion last year. But profits took a big jump to $891 million ($0.76 per diluted share) compared to $587 million ($0.49 a share) in the previous fiscal year.

Dividend and buybacks: The shares pay a quarterly dividend of $0.3325 ($1.33 a year) to yield 1.5% at the current price.

During the first quarter the company repurchased a total of $500 million worth of TJX stock, retiring 6.5 million shares. The company continues to expect to repurchase about $2.0 to $2.5 billion worth of stock during the current fiscal year.

Outlook: The company expects overall comparable store sales to be up 2% to 3% this year. Pretax profit margins are expected to range between 10.3% and 10.5%. Diluted earnings per share are forecast to be in the range of $3.49 to $3.58.

Action now: TJX continues to offer great values and fashion brands to its customers across its segments and regions. Hold.

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Outlook: Looking ahead, Ms. Rentler said the uncertain macroeconomic and geopolitical environments suggests a conservative approach to guidance. As a result, the company projects comparable store sales to be relatively flat this year. If sales perform in line with this plan, earnings per share for the 53 weeks ending Feb. 3, 2024 are expected to be $4.65-$4.95 compared to $4.38 in fiscal 2022. Ross plans to open about 100 new stores in 2023, expanding its footprint and market share in the off-price sector.

Action now: Hold.

CGI Group TSX: GIB.A, NYSE: GIB

BUY

Originally recommended on Aug. 19/12 at C$24.42, US$24.66. Closed Friday at C$138.60, US$103.03.

Background: Montreal-based CGI is the one of the largest independent information technology and business process services firms in the world. The company, founded in 1976, delivers an end-to-end portfolio of capabilities, from IT and business consulting to systems integration, outsourcing services, and intellectual property solutions. It employs about 91,500 professionals in offices and delivery centres across the Americas, Europe, and the Asia Pacific region. Revenue in fiscal 2022 was $12.87 billion.

Performance: The stock is down from its 52-week high of $142.31 but is still ahead about 18% year to date. We have a capital gain of 467% since the original recommendation.

Recent developments: The company recently released third quarter 2023 results. Revenue and earnings were up year-over-year but fell short of estimates on both counts. Revenue was $3.62 billion. That was up 11.2% year-over-year (6.3% in constant currency) but slightly below consensus projections. A slowdown in organic growth contributed to the revenue shortfall.

Net earnings were $415 million, up 13.9% year-over-year, for a margin of 11.5%. Diluted earnings per share were $1.75, up 15.9% year-over-year. In both cases, the company missed estimates.

On the bright side, CGI reported bookings of $4.39 billion, for a book-to-bill ratio of 121.1%. The company's backlog now stands at $25.63 billion or 1.8 times annual revenue. Return on invested capital (ROIC) was 15.7%, a decrease of 10 basis points when compared to the prior year, and up 10 basis points sequentially.

Balance sheet: As of June 30, long-term debt and lease liabilities, including both current and long-term portions, were $3.77 billion, down from $3.84 billion at the same time last year. As of the same date, net debt stood at $2.28 billion, down from $3.07 billion on June 30, 2022. The net debt-to-capitalization ratio stood at 21.7% at the end of June 2023, down 890 basis points when compared to the prior year.

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CGI Group—continued from page 12...

Dividend and buybacks: CGI does not pay a dividend, preferring to use the money for expansion. However, the company is actively buying back shares. During the quarter, CGI invested $53.1 million under its current Normal Course Issuer Bid to purchase 390,100 of its Class A subordinate voting shares for cancellation, at a weighted average price of $136.02.

Outlook: The company sees artificial intelligence as a long-term tailwind according to a research report from RBC Capital Markets, written by analyst Paul Treiber and his team. "AI may shift the industry from inputs-based pricing (i.e. labour) to outputs-based pricing, which is aligned with CGI's value propositions," they wrote. RBC maintained its price target of $155.

Action now: Buy for long-term growth.

YOUR QUESTIONS Rail stocks

Q – Which rail stock – CN or CP – do you recommend now and for future growth 5 to 10 years out? – Ray V.

A – Both are excellent companies, with a strong history of growth. If we focus only on the share price, CN Rail (TSX: CNR, NYSE: CNI) has seen its stock increase by 1,460% since Sept. 1, 2001. CP Rail, now known as Canadian Pacific Kansas City Ltd. (TSX, NYSE: CP) has done better, with growth of 1,922% in the same period. CP's $31 billion acquisition of Kansas City Southern in December 2021 greatly increased the company's footprint in the southern US and Mexico. The company operates 20,000 miles of track, providing connectivity to Canada's Atlantic and Pacific coasts, the Gulf of Mexico, and a port on Mexico's Pacific Coast. With the integration of the two railroads continuing, it would appear that CPKC has more upside. – G.P.

PRO'S PLATFORM Yields

Comment: Read your article on yields. Just wanted to point out that the yield on CSAV will remain around the current rate 5.14% for as long as the Bank of Canada keeps rates steady. Our yield moves pretty much in lock step with the overnight/ prime rate. If it goes up 25 basis points, our yields rise accordingly, same for them decreasing. There is no duration risk, unlike bond ETFs or funds. Another fixed income idea is our CI Convertible Bond ETF (TSX: CXF) which returned 6.4% last year. It has a yield to maturity of 5.7% and a current yield of 5.2%. Since inception, over 10 years ago, it has returned 4.8% annualized and is a 5-Star fund on Morningstar over 3, 5, and 10 years. – David Barber, CAIA, Vice President, National Accounts, CI Global Asset Management