Rogers: Nice dividend, risky stock price

By JOHN HEINZL
May 1, 2012 Globe and Mail

Telcom giant can boast of tripled dividend in past five years but one analyst questions if that can be sustained over next five

Ever since it started paying regular dividends in 2003, Rogers Communications RCI.B-T has been an income investor's dream.

Buoyed by steadily rising cable and wireless revenue, the Toronto-based communications giant has hiked its dividend eight times, including an 11.3-per-cent increase announced in February. In the past five years alone, the dividend has more than tripled, to the delight of investors looking for alternatives to the anemic yields of bonds.

But if you think Rogers - whose stock now yields 4.3 per cent - can keep up such a heady pace of dividend increases, you could be in for an unpleasant surprise.

"The kind of dividend growth they have been able to deliver to the marketplace over the last five years, that is not going to come through over the next five years," said ***Neeraj Monga***, an analyst with ***Veritas Investment Research.***

Admittedly, ***Mr. Monga*** has one of the most bearish views on the Street. He is the only Canadian analyst with a "sell" rating on the stock, and his intrinsic value estimate of $36 is well below the average target price of $40.17. The stock closed Tuesday at $36.68.

Yet, he has demonstrated a knack for sniffing out trouble, as shown by his prescient warnings on flameouts, such as Yellow Media, Research In Motion and Timminco.

While he isn't predicting the same sort of collapse at Rogers, he does think the stock is heading lower and believes the dividend will increase "at a much slower rate." And he's not the only analyst warning that Rogers is facing stiff headwinds in both its wireless and cable divisions.

"Rogers is being pressured on all sides - it continues to face a tougher competitive environment in wireless that is impacting ARPU [average revenue per user] and margins, while Bell's aggressive rollout of IPTV [Internet protocol TV] is starting to have an impact on the cable division," Desjardins Securities analyst Maher Yaghi said in a note after Rogers announced first-quarter results on April 24 that fell well short of analyst estimates.

Hammered by falling wireless margins and the loss of 21,000 basic cable subscribers, consolidated revenue fell 1.1 per cent and earnings before interest, taxes, depreciation and amortization dropped 5.9 per cent. For investors, what's perhaps most worrisome is that there are no signs that the negative trends will reverse any time soon.

The results were so bad that UBS Securities Canada analyst Phillip Huang said there is a "high likelihood" that management will cut its guidance when Rogers reports second-quarter results this summer. That could lead to more downside for the stock, which plunged nearly 6 per cent the day after the first-quarter results were released - the biggest drop in 18 months.

To be sure, Rogers has a lot of strengths, including a solid balance sheet, investment grade credit rating and strong free cash flow. But while the dividend is safe at current levels and may even grow slowly, the big risk for investors is a falling share price, ***Mr. Monga*** said.

His $36 intrinsic value estimate is based on a discounted cash flow analysis, which estimates Rogers' future earnings and works backward to figure out what they would be worth in today's dollars, taking into account time, risk factors and capital expenditure requirements.

That's not to say he recommends buying the shares if they get to that level. To generate an adequate return and build in a margin of safety, he said investors should only consider buying at a price at least 15 per cent below his intrinsic value estimate - or $30.60. That's assuming the outlook for Rogers doesn't change in the meantime.

"It's no longer the stable, hang-your-hat business it was," ***Mr. Monga*** said. "There are multiple things happening that make it more of a valuation story."

The key question investors need to ask is: "Are you buying it at a value where the probability of upside outweighs the probability of downside?"

Right now, ***Mr. Monga*** would answer that question with a firm "no”.