Rogers faces squeeze as competition heats up

By NICOLAS JOHNSON, Globe and Mail
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New players in wireless and cable sectors taking a toll on profit and stock price

The future looks choppy for Rogers Communications Inc. RCI.B-T as intensifying competition in the mobile phone and cable industries drives down profits and weighs on the company's stock.

Mobilicity, Public Mobile and Wind Mobile are among the upstarts joining giants BCE Inc. BCE-T and Telus Corp. T-T in offering cheaper rates to lure customers away from Rogers, Canada's biggest wireless network operator. At the same time, BCE is heating up the rivalry in cable.

The new plans might lower costs for clients, but they're crimping earnings and cash at Rogers, threatening to slow dividend increases and share buybacks at a company appreciated for its payouts.

Operating profit and average monthly revenue per user (ARPU), a key industry benchmark, have been declining at Rogers' phone unit, the biggest of its three businesses. The division has been winning new clients, and more of them are opting for Internet-capable smart phones with voice and data plans that generate almost double the ARPU of voice-only plans. But as more customers upgrade to more expensive handsets and monthly plans, the rate of revenue growth has slowed and costs to retain them have increased, said ***Neeraj Monga***, an analyst at Toronto-based ***Veritas Investment Research***.

Rogers shares have suffered, too, rising by less than half as much as BCE this year and a third as much as Telus. The stock plunged by the most in 20 months last Oct. 26 and took another whack in July after the company reported lower profits. Rogers presents third-quarter results next Wednesday, and ***Mr. Monga*** expects the company to cut its forecast for earnings at the mobile phone unit.

"Wireless is the cash engine, and we think that engine is going to slow down considerably in 2012-2013," ***Mr. Monga*** said in an interview. While "the dividend is safe," he said "the market is going to realize that the company isn't going to be able to provide the same level of dividend growth."

Veritas advises shareholders to sell their Rogers stock. It has "buy" ratings on BCE and Telus.

Investors are already betting against Rogers, BCE and Telus, as suggested by short interest in the companies at or near the highest levels in years, according to Bloomberg data.

The picture isn't completely bleak. Shares of all three operators have climbed this year even as Canada's benchmark equity index has tumbled, and Moody's Investors Service said this month that it boosted Rogers's debt rating "on expectations that the company will continue to record strong financial performance."

And the upstarts won't take away huge chunks of business overnight, even with their cheaper calling plans. New entrants will have 5 per cent of the market by the end of this year and 12 per cent by the end of 2014, according to a September report by Toronto-based Convergence Consulting Group Ltd.

A spokesman for Rogers said Thursday that retention costs rise in step with increases in revenue, and that the company has some of the widest profit margins in the wireless industry.

"We rate shares of Rogers Communications a buy given its strong position in the Canadian wireless and cable industries," Rick Franklin, an analyst at Edward Jones, said in a research report this month. "We believe both industries have good growth characteristics going forward, and we expect Rogers to be a direct beneficiary."

Veritas expects Rogers' cable unit to report higher third-quarter EBITDA - earnings before interest, taxes, depreciation and amortization - than the company forecast, but expects growth to slow as BCE's Fibe TV television service puts pressure on Rogers' offering

Rogers "faces significant challenges," Dvai Ghose, an analyst at Canaccord Financial Inc. with a "hold" rating on the shares, said in a research note last week. Of the four challenges Mr. Ghose highlighted, No. 1 was "industry leading ARPU and margin pressure."