Research Note: Bell Canada Enterprises

Industry: Canadian Telecommunications Services

Bell Canada Enterprises ("BCE") reported 4Q2012 earnings yesterday, and the following is a discussion of their results and a reaffirmation of our $49 price-target. Our investment thesis rested primarily on three factors: an attractive valuation, 13.4x 2013E price-earnings or a 16% discount to its American peers; a dividend-yield of 5.4% and a track-record of dividend increases in excess of 5%; and finally, the favorable economics of the Canadian telecommunications market. Canada’s wireless penetration rate remains low at 76%, compared with over 100% in the United States, and its smartphone penetration is only 40%. Moreover, the industry has only three major wireless carriers and longer contracts than the American market.

Fourth quarter revenue was largely in-line with expectations at $5.20 billion (versus $5.18 BCF estimated), and full year 2012 revenue was $19.98 billion (versus $20 billion BCF estimated), representing a 2.5% increase over the prior year. Further, full-year earnings-per-share hit our expectations, and consensus expectations, at $3.21. Perhaps most importantly, the company surprised investors by announcing its seventh dividend increase in the past five years, up $0.06 to $2.33 per share, and its annual dividend has increased, in aggregate, over 60% since 2008. Despite some share price appreciation, the stock’s current yield remains above 5% post-dividend increase, on a free cash-flow payout ratio below 80%.

On the subscriber-front, net-additions in the wireless division were up 3.4% over 2011, while IP television subscribers increased 2.5% over the same period. Correspondingly, wireless ARPU increased 4.1%, and the company expects further increases resulting from heightened smartphone penetration. As expected, access-line declines numbered 7.5%, and broadband growth of 0.1% failed to mitigate the effects of wireless substitution. Capital intensity was 17.6% (18% BCF estimated), while free cash-flow was up 7% to $2.40 billion ($2.36 billion BCF estimated). While United States telecom carriers begin to ramp-up their capital expenditures, predominantly intent upon continued 4G network build-outs, and Bell’s Canadian peers attempt to replicate the company’s fiber-optic network, Bell’s historical emphasis on continued capital investment render increases in capital intensity unnecessary in the near-term. The Telecom & Utilities team found that there is a -70% correlation between increases in capital expenditures and the quarterly return of a telecom stock, on a two quarter-lag, and this notion was another critical element to our purchase of Bell over Rogers and TELUS.

On a more qualitative note, Bell has resubmitted the proposed acquisition of Astral Media, a transaction which would significantly augment existing content within the company’s “Bell Media” division. Bell expects a response from the CFTC in the first half of 2013.

The BCF has an approximately 6% gain in the position, including dividends, and we will continue to monitor the Astral situation carefully. In the meantime, the Telecom & Utilities team is happy to field any questions or concerns, either at, or in advance of, Monday’s meeting.