Weekly Trends

PRIVATE CLIENT SOLUTIONS

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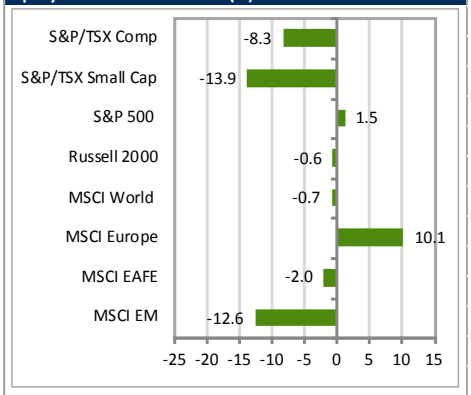
Calling On Telecoms

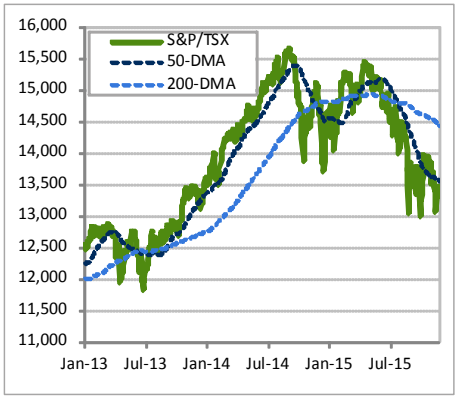
- The Canadian telecom sector faced a number of challenges in 2013 and 2014, as earnings slowed and concerns of a new entrant weighed on the sector. However, these headwinds have abated more recently which in part explains the sector's solid performance year-to-date (YTD).
- Given the improving fundamental and technical backdrop we have had the sector on upgrade watch and today are officially upgrading the sector to overweight.
- Our bullish view of the sector is predicated on: 1) improving earnings (sector is forecasted to grow earnings at 6.4% in 2016); 2) solid dividend growth; 3) improving technicals; 4) diminished risk of a new entrant; and 5) historically the sector has outperformed in the first year after the US Federal Reserve (Fed) hike rates (see Chart of the Week).
- Our preferred name in the sector is Telus Corp. (T-T). The shares have recently pulled back to good technical support around the $40 level. We would use this weakness to establish or add to positions given our bullish outlook on the sector and company.

Equity Market YTD Returns (%)



Canadian Sector	TSX Weight	Recommendation
Consumer Discretionary	7.1	Overweight
Consumer Staples	4.5	Market weight
Energy	18.9	Market weight
Financials	38.3	Market weight
Health Care	2.6	Market weight
Industrials	8.4	Overweight
Information Technology	3.0	Overweight
Materials	9.4	Underweight
Telecom	5.6	Overweight ↑
Utilities	2.2	Underweight

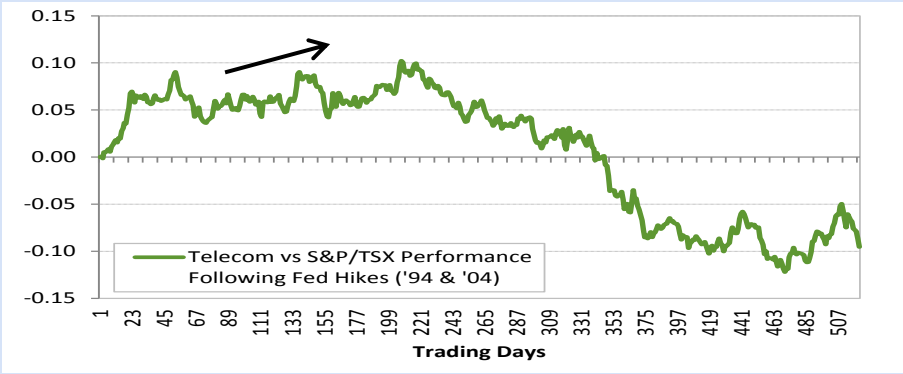
Technical Considerations	Level	Reading
S&P/TSX Composite	13,425.2	
50-DMA	13,567.1	Downtrend
200-DMA	14,437.2	Downtrend
RSI (14-day)	46.4	Neutral



Source: Bloomberg, Raymond James Ltd.

Chart of the Week

Canadian Telecom Sector Outperforms In First Year Following Fed Rate Hikes



Source: Bloomberg, Raymond James Ltd.

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RAYMOND JAMES

Calling On Telecoms

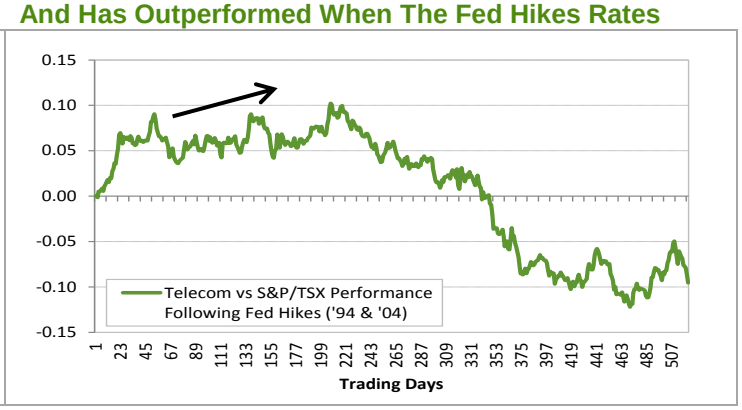
The Canadian telecom sector faced a number of challenges in 2013 and 2014, as earnings slowed and concerns of a new entrant weighed on the sector. However, these headwinds have abated more recently which in part explains the sector's solid performance YTD. As of November 26, the S&P/TSX Capped Telecommunications Index is up 8.4% YTD, outperforming the S&P/TSX by roughly 16%. Given the improving fundamental and technical backdrop we have had the sector on upgrade watch and today are officially upgrading the sector to overweight. In this week's publication we outline the bullish case for the Canadian telecom sector and provide our top pick in the sector. The key factors supporting our sector upgrade include:

- **Improving earnings:** Earnings growth flat-lined in 2012 and 2013 but turned positive beginning in 2014. This year earnings are forecasted to rise 5% Y/Y followed by a 6.4% rise in 2016. Assuming valuations remain unchanged in 2016, total returns including dividends could be roughly 10% for the sector.
- **Reasonable valuations:** With the strong price appreciation this year, valuations have expanded, but we believe they are justified given the improving fundamentals. Currently, the telecom sector trades at 17x forward earnings (10% premium to long-term average) and 8.8x EV/EBITDA (33% premium). Our base case view is that the telecom sector will rise in-line with earnings growth (limited multiple expansion) in 2016.
- **Solid dividend growth:** The sector continues to deliver strong dividend growth. This year Cogeco Cable increased its dividend 17% Y/Y, Telus 10%, BCE 5.3% and Rogers at 5%. We see this continuing in 2016 with Telus leading the pack.
- **Improving technicals:** The sector continues to show relative strength, with the sector outperforming and making new relative highs (versus the S&P/TSX).
- **Competitive landscape:** While there is still the potential for a new fourth national wireless carrier, we believe this risk has diminished or been delayed, particularly with Verizon deciding not to enter the Canadian marketplace.
- **Sector outperforms when Fed hikes:** With the Fed expected to hike rates in December, we analyzed Canadian sector returns following previous tightening cycles. During previous tightening cycles the telecom sector has outperformed the S&P/TSX by 10% on average, in the first year following the rate increase.

Putting it all together, given the improving fundamentals and technicals, and historical outperformance following Fed rate hikes, we are upgrading the sector to overweight.

Telecom Sector Is Outperforming The S&P/TSX

And Has Outperformed When The Fed Hikes Rates



Source: Bloomberg, Raymond James Ltd.

Telus Corp.

The big winners this year have been Rogers Communications and Manitoba Telecom. Rogers shares rallied sharly in October after the company reported a better-than-expected quarter. Historically, Rogers has experienced lower wireless suscriber additions, has lower Average Revenue Per User (ARPU) metrics than its peers, and has a higher churn rate (percentage of subscribers who discontinue their services), which set a low bar for Q3/15 results. With the company beating the low expectations, the stock reacted favourably and rallied over $8 in October. Despite the strong performance YTD we don't believe the company can sustain this momentum and therefore we prefer other companies in the sector. Manitoba Telecom has benefited from the sale of its Allstream division, with some believing the company will now be a takeout target. While this is a real possibility, with Telus most likely being the acquirer given its dominance out west, we prefer to focus on the best-in-class operators and why Telus Corp. is our preferred pick. Our bullish view of Telus is predicated on the following:

- **Best in class operator:** We view Telus as the best operator in the industry given its consistently higher subscriber growth, lower churn ratios, and high ARPU metrics. As a result, the company has delivered industry-leading revenue growth of 4 to 5% annually since 2010.
- **Earnings:** This then flows down into earnings, with the company delivering strong EPS growth and higher ROEs. Telus is expected to deliver 5% Y/Y EPS growth in 2015, followed by 13% next year. According to analysts, Telus has the highest expected long-term growth rate of 12%.
- **Dividend growth:** A big reason why we prefer Telus and hold the stock in our Dividend Plus+ Guided portfolio is due to its high dividend growth rates. The company's 3-year annualized dividend growth rate is 11.3% versus Rogers at 7.2% and BCE at 5.7%. The company has committed to growing its dividend at 10% annually, making the stock a core holding for dividend investors.
- **Highest return of capital:** In addition to dividend increases the company is also aggressively returning capital to shareholders through share repurchases. Over the last three years the company has bought back roughly $2 bln in shares or 7% of the outstanding float. Management has indicated that it will purchase another $500 mln in stock in 2016.
- **Good entry point**: Telus shares declined in early November following an "in line" quarter. The shares have recently pulled back to good technical support around the $40 level. We would use this weakness to establish or add to positions given our bullish outlook on the sector and company.

We see the telecom sector outperforming next year which is why we hold both Telus Corp. and BCE in our Dividend Plus+ Guided portfolio. While we like both names we currently tip our hat to Telus and recommend investors buy on this weakness.

Canadian Telecom Comp Table

		Last	Qtrly	Dvd Growth	Dvd	Valuation		EPS		Earnings Growth	
Company	Ticker	Price	Dvd	3-Year	Yield (%)	P/E (NTM)	EV/EBITDA	2015	2016	2016 Y/Y	Long-term
TELUS Corporation	T-CA	$41.33	$0.42	11.3%	4.26	15.3	8.4	$2.42	$2.74	13%	12%
BCE Inc.	BCE-CA	$56.45	$0.65	5.8%	4.61	15.9	8.0	$3.39	$3.56	5%	7%
Rogers Communications Inc. Class B	RCI.B-CA	$51.42	$0.48	7.2%	3.73	17.0	7.7	$2.93	$3.04	4%	0%
Manitoba Telecom Services Inc.	MBT-CA	$30.27	$0.33	-4.1%	4.29	22.4	5.2	$1.17	$1.37	18%	-35%

Source: Factset, Raymond James Ltd.

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A member of the PCS team responsible for preparation of this newsletter or a member of his/her household has a long position in the securities of Telus Corp. (T-T).