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COMMENTARY – Look beyond the brinkmanship on the US debt-ceiling issue

This is a good time to be accumulating blue-chips at attractive valuations

Elvis Picardo, CFA

We have no way of knowing what will transpire in Washington over the weekend and next week. What we do know is that the recent sell-off makes this a suitable time to accumulate blue-chips that are trading at attractive valuations

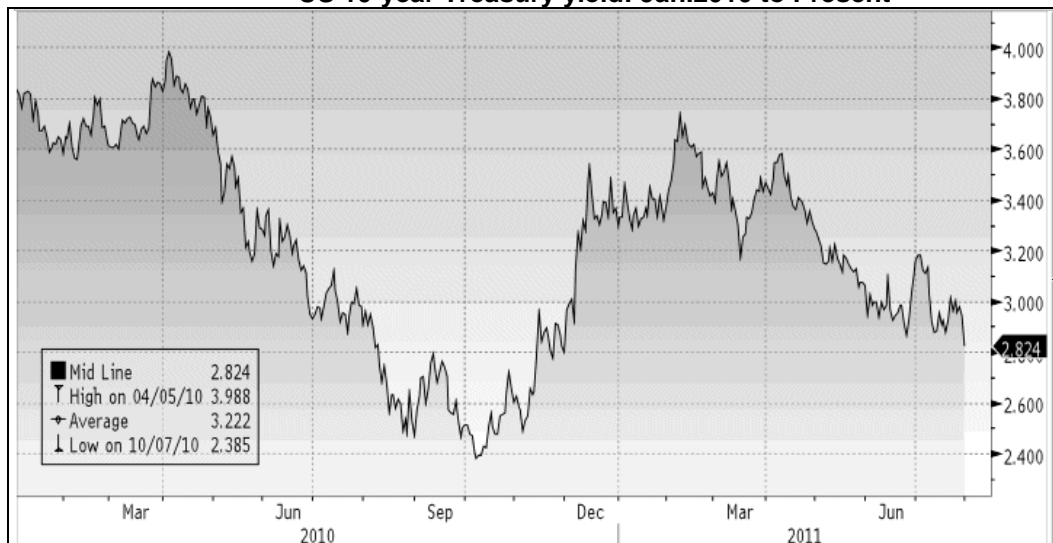
One unfortunate effect of the US debt-ceiling impasse is that it has brought the whole sovereign debt issue to the forefront in recent months. The debt woes of Greece and other highly-indebted European nations has exacerbated the situation and weighed on investor sentiment for weeks. While we are not attempting to trivialize the seriousness of the sovereign debt issue, our view is that it may be a factor that affects sentiment on a temporary basis – such as at present – but perhaps not permanently.

We believe cooler heads will prevail and the US will reach an agreement to increase the borrowing limit. To use an oft-quoted cliché, politicians will likely “kick the can” down the road in an attempt to buy time to make the really difficult decisions with regard to controlling runaway US debt.

Bond investors currently see little reason to worry about a potential US debt default, or downgrade for that matter. As the chart below indicates, the yield on US 10-year Treasuries has declined by 13 basis points today to 2.82%.

Bottom-Line: The House of Representatives plans to vote on Speaker John Boehner’s debt plan today, with CNN indicating that the voting may happen between 7 and 8 pm EST. Even as investors fret about the possibility of financial Armageddon for the second time in less than three years, we would advocate adding to or initiating positions in select blue-chips that have sold off disproportionately in recent weeks. On the Canadian side, stocks such as **Rogers Communications, Suncor** and **Sherritt** look like great value for long-term investors.

US 10-year Treasury yield: Jan.2010 to Present



Source: Bloomberg

(Trade Update) Rogers Communications – Reiterate Buy, target raised to \$41

We continue to recommend **Rogers Communications (TSX: RCI/B, \$36.56)** as a Buy for growth-oriented investors who seek above-average dividend yields.

Rogers came close to our \$39.25 target earlier this month, reaching a nine-month high of \$39.13 on July 5. The stock has declined 6% from that interim high, with part of that drop attributed to the company's Q2 report that was released on Tuesday.

Revenue for the quarter rose 3.2% from a year earlier to \$3.12 billion, a little short of analysts' average estimates of \$3.13 billion. Net income fell 9.3% to \$410 million or \$0.75 per share; EPS excluding items was \$0.85, beating analysts' average estimate of \$0.81.

Investors were concerned by a drop in profits at the company's Wireless segment, where operating profit fell 7% to \$761 million. Operating revenue rose 0.6% to \$1.56 billion, driven by continued growth in the postpaid subscriber base (up 45,000) and increased adoption of wireless data services. Wireless data revenue continued to grow, up 31% from a year ago to \$572 million, reflecting continued penetration and growing usage of smartphone and wireless laptop devices. Data revenue accounted for about 35% of total network revenue, compared with 27% a year ago.

The Wireless segment activated and upgraded 591,000 smartphones – predominantly iPhone, Blackberry and Android devices – in the quarter, up from 534,000 in Q1 and 385,000 a year ago. Smartphone subscribers represented 48% of the overall postpaid subscriber base as at June 30, up from 45% at March 31 and compared with 35% a year ago.

In the postpaid segment, average revenue per user (ARPU) continued to decline, another concern for investors. Postpaid ARPU in Q2 fell to \$70.07, down 4.0% from \$73.07 a year ago, and down marginally from \$70.18 in Q1. Overall, average monthly minutes of usage for all users fell to 475 in Q2 from 495 a year ago, but improved from 450 minutes in Q1. While blended ARPU for all users fell 4.8% in Q2 to \$60.26 from \$63.27 a year ago, it improved marginally from \$59.91 in Q1.

On the positive side, net postpaid subscriber additions were 108,000, significantly higher than analysts' average estimates of 83,000 additions. New smartphone customer additions also set a new quarterly record.

Rogers left its full-year sales and profit guidance unchanged from February. Analysts' EPS estimates continue to be little changed since our initial recommendation on February 18, at \$3.05 for FY11 and \$3.28 for FY12. On that basis, the stock trades at a forward multiple of 12x FY11 EPS. Our price target, derived from a 12.5x multiple applied to FY12 EPS of \$3.28, is now at \$41, an upward revision from our earlier \$39.25 target.

We expect Rogers to be supported by its dividend yield of 3.9% and \$1.5-billion stock buyback, and believe the reward-risk payoff continues to be attractive for investors with moderate risk tolerance.

Disclosure: The writer of this report or a family member holds long positions in the following securities – Suncor.

Market Snapshot at 12:50

S&P TSX	12944.70	-103.08	Commodities			Yields (%)	Can.	US
TSX Venture	1977.12	-6.83	Canadian \$	1.0467	-0.0068	90 Day T-Bill	0.91	0.10
DJIA	12140.51	-99.60	Gold (Spot)-US\$	1624.48	+8.53	2-Year Bond	1.39	0.36
S&P 500	1292.23	-8.44	Oil (WTI-Sept.)	95.92	-1.52	10-Yr.Bond	2.78	2.80
NASDAQ	2758.51	-7.74	CRB Index	342.08	-2.57	30-Yr. Bond	3.28	4.14

Thought for the Day

“We find comfort among those who agree with us – growth among those who don’t.”
– Frank A. Clark

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