



Fletcher poised to end Telecom's reign

By KRIS HALL - The Independent Last updated 11:09 18/09/2009

Telecom's days as New Zealand's top stock appear numbered, with investors picking a sustained period of dominance for Fletcher Building in light of the contrasting fortunes embracing the two corporate heavyweights.

Telecom faces a period of regulatory and competitive pressure during which earnings growth has hit a brick wall. And with the prospects for residential property and infrastructure strong, Fletcher is seemingly through the worst of its cyclical storm. Its case is further boosted by the Reserve Bank's reluctance to raise interest rates given manufacturers and exporters are still struggling and facing a high-exchange rate. But the low rates are showing early signs of fuelling the next property boom.

NZ Funds chief investment officer Michael Lang says the Reserve Bank's catch-22 dilemma is a big plus for Fletcher because several of the company's high-margin sales come through residential property. "In contrast, Telecom faces more competition every day and, unlike Fletcher's core businesses, technology is bringing down the barriers to entry for new competition. Telecom is effectively a commodity," Lang said.

At the time of writing, the market capitalisation gap is about \$200 million between Telecom (\$5.06 billion) and Fletcher (\$4.78b). Telecom's plight has hardly been helped by its troubled push through AAPT into Australia - a huge market for Fletcher - and the company's tendency to jump from hero to zero in the technology stakes, market commentator Arthur Lim says.

"Telecom's lack of overseas exposure and recent lack of progress in technology point to a grossly mismanaged company, which is what it is and that's what's scaring off investors," Lim said.

Telecom, which recently posted a 44 per cent fall in annual net profit to \$398m, doesn't expect earnings to rise till 2011.

Aside from a blip last year when Contact Energy's market capitalisation briefly spiked above Telecom, the telco has largely presided over the rest of the sharemarket since its 1991 float.

Telecom was forced into a three-way operational separation by the previous government and even the stock exchange has endeavoured to curtail Telecom's dominance, most notably by creating a free float-based index and then later by adopting a new gross index which included dividends.

Yet the defensive stock remained a favourite with overseas investors. But with more investors questioning the benefit of passive index tracking funds, Lang says it will be Telecom that faces the fallout from growing apathy for a strategy that allocates most money to the most overvalued company.

"The crossover of Fletcher and Telecom is a good example of the merit of actively picking a selection of good companies instead of using an index fund."

On the earnings front, Fletcher is set to benefit by virtue of cyclical exposure to generate more upside, a factor enhanced by its international presence.

"Then you've got Telecom sat in an industry where product lifetime is much shorter and depreciation is therefore higher. It's just not an attractive industry," ING senior investment analyst Craig Brown said.

Fletcher's case is bolstered, says Brown, by the ease with which it can raise additional funds, such as the \$505m raised in April through issuing new shares, to drive future acquisitions. This in turn creates greater earnings growth.

The point rings true with his peers.

"Telecom's lack of earnings growth appears to be its final demise with even the Government looking to minimise the company's ability to grow," Tyndall Investment Management's Rickey Ward said. "Fires isn't the right term, but Telecom's got a whole load of things it has to [try to] control which are outside of its control. It's spending money to stand still."