



# Telephone & Data Systems (TDS)

Updated April 27<sup>th</sup>, 2018 by Nate Parsh

## Key Metrics

<b>Current Price:</b> \$29	<b>5 Year CAGR Estimate:</b> 8.0%	<b>Quality Percentile:</b> N/A
<b>Fair Value Price:</b> \$33	<b>5 Year Growth Estimate:</b> 3.0%	<b>Momentum Percentile:</b> N/A
<b>% Fair Value:</b> 87 %	<b>5 Year Valuation Multiple Estimate:</b> 2.8%	<b>Total Return Percentile:</b> N/A
<b>Dividend Yield:</b> 2.2%	<b>5 Year Price Target</b> \$37	<b>Valuation Percentile:</b> N/A

## Overview & Current Events

Telephone & Data Systems is a telecommunications company that provides customers with cellular and landline services, wireless products, cable, broadband and voice services in 34 states. The company's Cellular Division provides the vast majority of sales (~77%). TDS started in 1969 as a collection of 10 rural telephone companies. Today the company has a market cap of \$3.2 billion and had more than \$5 billion in sales in fiscal 2017.

TDS released 4<sup>th</sup> quarter fiscal 2017 earnings on February 23<sup>rd</sup>, 2018. The company reported earnings-per-share of \$0.05, \$0.09 above estimates. Revenues grew 2.3% to \$1.31 billion. U.S. Cellular, of which TDS owns a large share, showed positive net income in Q4 versus a loss the previous year. U.S. Cellular also added 5,000 postpaid subs. TDS's residential wireline, broadband and voice connections all declined year-over-year and from the previous quarter. Commercial wireline connections fell year over year and from Q3 as well. Cable connections was the lone service that saw an increase year over year. TDS expects its tax rate will decline to 21% from 35% thanks to recent tax reform legislation.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$0.74	\$1.63	\$1.25	\$1.68	\$0.75	\$1.29	\$1.26	\$1.98	\$0.39	\$0.53	<b>\$0.35</b>	<b>\$0.41</b>
<b>BPS<sup>1</sup></b>	\$30.88	\$32.81	\$33.75	\$33.60	\$37.16	\$37.85	\$36.39	\$37.86	\$37.67	\$38.42	<b>\$39.00</b>	<b>\$44.00</b>
<b>DPS</b>	\$0.38	\$0.40	\$0.41	\$0.43	\$0.49	\$0.51	\$0.54	\$0.56	\$0.59	\$0.62	<b>\$0.64</b>	<b>\$0.93</b>

TDS experienced an earnings-per-share decline of 78% in 2008, before EPS returned to growth in 2009. While this is positive, recent earnings results have been poor. From 2008 through 2017, earnings declined 3.3% per year. Earnings are expected to decline even further in 2018 (down 34%). The company is expected to show earnings growth again in 2019, but with almost every aspect of the company declining it is unclear how growth is sustainable. The one aspect of the company performing well is TDS's stake in U.S. Cellular. While the earnings trend has been spotty at best, book-value-per-share has grown at 2.2% a year over the last decade. The book value trend is much more consistent. We are not particularly impressed with TDS' growth prospects. We are projecting 3% growth going forward, but even this low hurdle may prove to be too generous.

TDS has increased its dividend for 44 consecutive years. The company last raised its dividend 3.2% on February 23<sup>rd</sup>. The company has increased its dividend by 4.7% per year over the past 10 years. TDS does have a sizeable cash position (almost \$3.60 per share as of 12/31/2017). While earnings do not cover the dividend here, cash flows do. Given the cash balance and possible earnings growth related to U.S. Cellular, the dividend could, in a best-case scenario, grow by 3% per year through 2023.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/B</b>	1.32	0.91	0.99	0.87	0.64	0.67	0.70	0.72	0.73	0.73	<b>0.74</b>	<b>0.85</b>
<b>Avg. Yld.</b>	1.0%	1.4%	1.4%	1.6%	2.1%	2.0%	2.1%	2.1%	2.1%	2.2%	<b>2.2%</b>	<b>11.6%</b>

<sup>1</sup> Book-value-per-share

Because of the volatility inherent in the company's earnings, we believe that the best way to assess Telephone & Data's valuation is by looking at its price-to-book ratio. The company's price-to-book ratio has steadily declined over the last decade and has traded at an average value of around 0.83. We believe that a price-to-book ratio of around 0.85 represents fair value for this telecommunications stock. Telephone & Data is trading at a price-to-book ratio of 0.74 today. If the company's price-to-book ratio can expand to 0.85 over the next 5 years, this will increase its expected total returns by 2.8% per year during this time period.

### Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	42.3%	41.4%	39.6%	38.2%	35.6%	30.1%	28.2%	29.7%	28.9%	28.9%	<b>30%</b>	<b>34.3%</b>
Debt/A	50.8%	50.5%	50.6%	51.7%	53.5%	53.7%	55.7%	56.2%	56.1%	54.1%	<b>53.9%</b>	<b>53.3%</b>
Int. Cov.	2.9	4.4	3.8	4.4	3.7	4.4	-0.4	4.2	1.6	0.3	<b>0.8</b>	<b>2.9</b>
Payout	51.4%	24.5%	32.8%	25.6%	65.3%	39.5%	42.9%	28.3%	151%	117%	<b>183%</b>	<b>227%</b>
Std. Dev.	68.4%	38.8%	25.6%	38.4%	31.8%	26.7%	28%	28.4%	26.7%	25.8%	<b>27.4%</b>	<b>33.9%</b>

TDS saw earnings decline drastically in 2008 but returned to growth in 2009. While this is impressive, the company's recent earnings results have seen drastic declines. The company's dividend payout ratio is above 100%, making it likely that dividend growth could be muted until earnings return to growth.

A positive for TDS is that though profitability has declined over the past 10 years, this metric has stabilized in recent years. Debt as a percentage of assets has also stabilized. If TDS can see a return to growth in the key areas and U.S. Cellular continues to perform well, then perhaps the company has brighter days ahead.

### Final Thoughts & Recommendation

Shareholders of TDS can expect a return of 8.0% per year through 2023. This total return is arrived at based on growth (3%), dividends (2.2%) and multiple reversion (2.8%). TDS is seeing subscriber declines in every service category. The lone bright spot is U.S. Cellular, but that company has struggled, too. This total return will be worse if U.S. Cellular's recent growth lacks momentum going forward. The best-case scenario for TDS might be trying to sell itself to one of the major telecommunications companies. Because Telephone & Data's expected returns are mediocre, we believe that interested investors should seek out a different telco company, with industry giant AT&T (T) being the most obvious example. AT&T offers a higher yield, greater safety, and significantly higher total returns.

### Total Return Breakdown by Year

