



CenturyLink (CTL)

Updated June 1st, 2018 by Josh Arnold

Key Metrics

Current Price: \$18	5 Year CAGR Estimate: 14.8%	Quality Percentile: N/A
Fair Value Price: \$15	5 Year Growth Estimate: 6.8%	Momentum Percentile: N/A
% Fair Value: 123%	5 Year Valuation Multiple Estimate: -4.0%	Total Return Percentile: N/A
Dividend Yield: 12.0%	5 Year Price Target: \$20	Valuation Percentile: N/A

Overview & Current Events

CenturyLink traces its roots to 1930 when the Oak Ridge Telephone Company was purchased by the Williams family. They would eventually expand the business exponentially into what has become CTL, which serves customers in 60 different countries today. The company has a \$20B market cap and should produce \$24B in revenue this year.

CTL's recently reported Q1 was a bit of a mixed bag as the Level 3 acquisition produced a 41% revenue increase. However, on a comparable operating basis, revenue fell 2% on declines in the company's three largest segments. In addition, operating expenses rose 45% and interest expense was up 68%, both the product of the Level 3 purchase, which was completed late last year. CTL has a lot of moving pieces at present and its balance sheet is in focus for investors given the additional leverage taken on by the Level 3 purchase. Overall, however, management is optimistic.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$3.37	\$3.46	\$3.41	\$1.07	\$1.25	\$1.64	\$2.61	\$2.72	\$2.45	\$1.58	\$1.15	\$1.60
DPS	\$1.54	\$2.80	\$2.90	\$2.90	\$2.90	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16

CTL's EPS history isn't particularly stellar as it has struggled in recent years with competition as well as profitability. A sharp drop in earnings in 2011 gave way to respectable growth but it doesn't appear CTL will be able to return to former levels of EPS in excess of \$3 anytime soon; it roughly doubled its share count in 2017 as a result of the Level 3 acquisition. In addition, it took on another \$13B in debt with the transaction onto a balance sheet that wasn't in good shape on its own. That has led to a much harder road ahead for net margins as well as EPS given the higher share count. That said, we see 6.8% annual growth going forward as CTL has some catalysts for earnings expansion. Revenue is slated to rise by roughly one-third this year thanks to Level 3 so that will certainly help CTL boost earnings moving forward, as synergies come on line. CTL believes it can achieve roughly \$1B in annual operating savings within three years with Level 3, savings that would provide significant margin expansion. It would also allow for CTL to potentially reduce some of its considerable debt, which is growing ever more expensive to service. We see a lower tax rate helping CTL get earnings growth back on track as well as long term demand for its services, although competition is brutal in this industry.

The dividend is a hot issue for CTL shareholders as it has been stagnant since a cut back in 2013. We don't see the payout rising anytime soon but management has reiterated its commitment to pay the dividend at all costs and avoid another cut. In addition, free cash flow guidance for this year is more than enough to cover the dividend so we see the payout as safe for the foreseeable future. Given the prodigious yield, this is perhaps even more important than earnings.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	10.0	8.9	10.9	36.2	31.4	21.3	14.0	11.6	11.4	13.9	15.7	12.8
Avg. Yld.	4.6%	9.1%	7.8%	7.5%	7.4%	6.2%	5.9%	6.9%	7.7%	9.8%	12.0%	10.5%

CTL's P/E multiple has moved around a bunch in the past decade as the company's fortunes have risen and fallen. It stands at 15.7 now, which is well in excess of its historical norm at 12.8 and as a result, we see it falling back to that level over time. CTL's much higher share count and debt totals are likely to keep a lid on the multiple as well moving forward. We see the yield falling as a result of a higher share price and flat payout, but it will still be very strong in excess of 10%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	63.3%	42.1%	63.9%	58.8%	58.4%	58.5%	56.5%	56.5%	55.5%	53.5%	52.5%	52.0%
Debt/A	62%	58%	56%	63%	64%	67%	69%	70%	72%	69%	70%	72%
Int. Cov.	3.8	3.2	3.8	1.9	1.9	1.2	1.8	2.0	1.8	1.4	1.4	1.4
Payout	44%	54%	85%	--	--	132%	83%	79%	88%	129%	188%	135%
Std. Dev.	40.1%	22.8%	16.5%	20.4%	13.5%	21.3%	19.0%	19.9%	36.3%	36.0%	38.0%	40.0%

CTL's quality metrics have largely deteriorated in the past decade, which is no surprise given how EPS and the stock have performed. Gross margins continue to fall and we see that trend continuing, although losses from here should be slight. Debt continues to be a problem but CTL's debt-to-asset ratio is actually reasonable at about 70%; we do see some upside here as CTL may be forced to take on additional debt to fund its Level 3 integration. Interest coverage is okay at 1.4 but shareholders would do well to closely monitor that situation as it is moving ever closer to 1. The dividend won't be covered by earnings in the foreseeable future but we do see the payout ratio falling significantly over time.

CTL's competitive advantage is in its diversified model as well as its massive size and reach. CTL has the ability to negotiate in ways smaller competitors cannot and its global footprint provides valuable diversification. It should perform well during the next recession as it did in the last one, so that is not a concern at this point.

Final Thoughts & Recommendation

CTL is a stock that is trading in excess of fair value but that offers decent growth potential and an enormous yield. We see total returns of 14.8% going forward, consisting mainly of the 12% current yield but also 6.8% earnings growth somewhat offset by a 4% headwind from the valuation. CTL's dividend looks safe for now and may be good enough for income investors but keep in mind CTL is not for the risk-averse. This is a high-risk, high-reward situation with many variables so more speculative investors may find CTL attractive here.

Total Return Breakdown by Year

