Deutsche Telekom AG (DTEGY)

Updated August 20th, 2018 by Nick McCullum

Key Metrics

Current Price:	$16	**5 Year CAGR Estimate:**	11.1%	**Volatility Percentile:**	17.5%
Fair Value Price:	$17	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	12.8%
% Fair Value:	94%	**5 Year Valuation Multiple Estimate:**	0.3%	**Valuation Percentile:**	71.7%
Dividend Yield:	4.8%	**5 Year Price Target**	$21	**Total Return Percentile:**	80.5%

Overview & Current Events

Deutsche Telekom is the largest telecommunications company in Europe and the second-largest telecommunications company in the world. The company operates through the following segments: Germany, United States, Europe, and System Solutions. The Germany segment provides fixed-network and mobile solutions as well as wholesale telecommunications services. The United States segment includes T-Mobile, while Europe encompasses all fixed-network and mobile operations outside Germany. The Systems Solution segment provides information and communication technology systems. Deutsche Telekom has over 160 million mobile customers, 29 million fixed-network lines, and more than 18 million broadband lines. United States investors can initiate an ownership stake in Deutsche Telekom through American Depository Receipts that trade over-the-counter under the ticker DTEGY with a market capitalization of US$80 billion.

In early August, Deutsche Telekom reported (8/9/18) financial results for the second quarter of fiscal 2018. In the quarter, net revenues declined by 2.8% while diluted earnings-per-share declined by 47.4%. The decline in profitability was due to higher personal costs, a higher proportion of net income being attributable to non-controlling interests, and a 2% increase in the number of shares outstanding. Excluding these factors and looking slightly further up on the income statement, Deutsche Telekom saw adjusted EBITDA declined by just 0.3% and its adjusted EBITDA margin expand to 32.3%, up from 31.5% previously. The company's performance through the first half of the year has been better. The company's earnings-per-share declined by 11.4% over the same six-month reporting period last year. Still, the markets were disappointed in Deutsche Telekom's financial performance and shares fell by around 4% following the earnings release.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$0.48	$0.64	$0.91	$0.92	$0.66	$0.63	$0.79	$0.77	$0.61	$0.89	***$1.10***	***$1.47***
DPS	$1.21	$1.04	$1.03	$0.99	$0.88	$0.93	$0.68	$0.56	$0.63	$0.65	***$0.70***	***$1.05***

Deutsche Telekom's earnings growth has been somewhat volatile, partially due to the spinoff of T-Mobile in 2012. Even including the impact of this spinoff, the company grew its earnings-per-share at a rate of around 6% per year over the last decade. We believe that this level of growth is likely to continue for the foreseeable future. We are forecasting earnings-per-share of $1.10 in the upcoming fiscal year. Applying a 6% growth rate to this estimate allows us to calculate our 2023 earnings-per-share estimate of $1.47.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	35.1	20.0	14.4	14.9	17.2	20.4	20.3	23.1	27.7	20.2	***14.5***	***15.0***
Avg. Yld.	7.2%	8.1%	7.9%	7.2%	7.7%	7.2%	4.2%	3.2%	3.7%	3.6%	***4.8%***	***4.5%***

Deutsche Telekom's valuation has been relatively volatile over the last decade, ranging from as high as 35 to as low at 14, with an average value of 21.3. We believe this historical valuation multiple is far too rich for a company like Deutsche Telekom. Given comparable valuations in the domestic telecommunications industry, our target for Deutsche Telekom's fair value is a price-to-earnings ratio of 15. For context, the company is trading at an earnings multiple of 14.5 today. If the company's price-to-earnings ratio can expand to 15 over a 5-year time period, this will add 0.7% to the company's annualized returns during this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

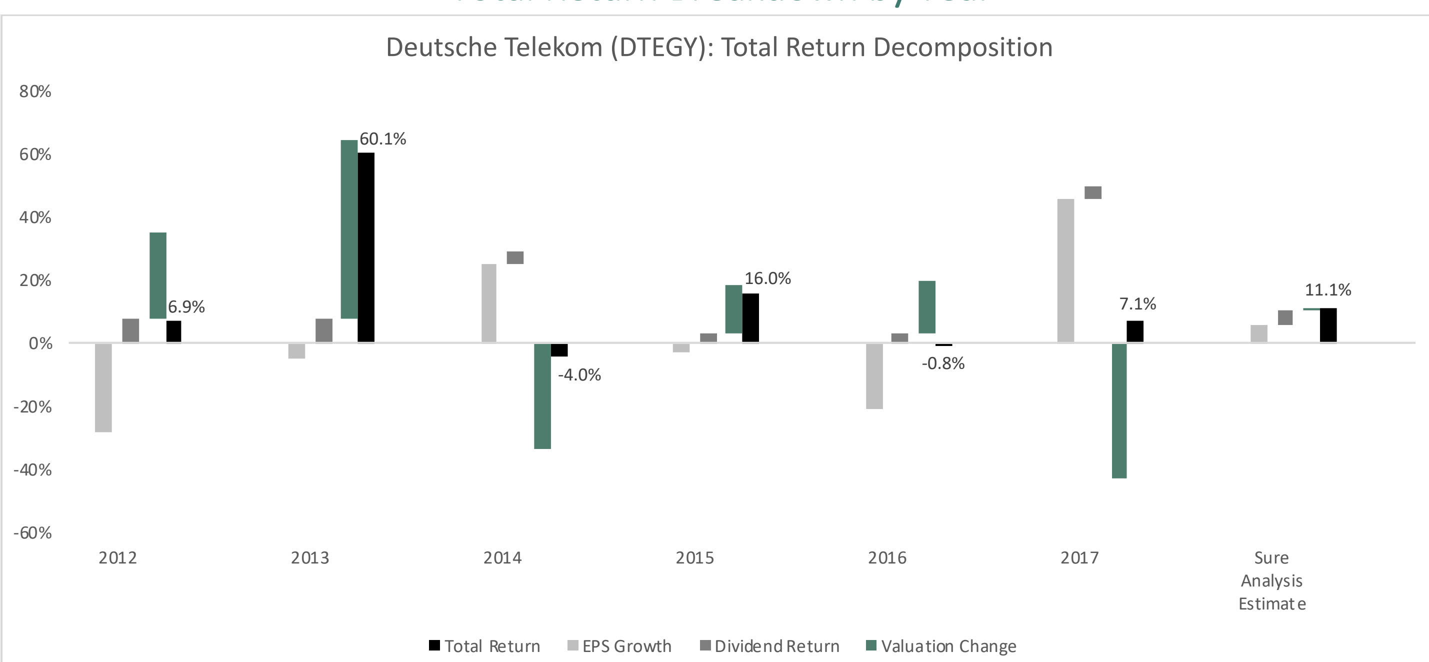
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	23.1%	21.6%	20.8%	21.7%	21.5%	19.4%	27.5%	25.1%	26.9%	26.1%	***25.0%***	***25.0%***
Debt/A	65.0%	67.2%	66.3%	67.3%	71.7%	72.9%	73.7%	73.5%	73.8%	70.0%	***70.0%***	***70.0%***
Int. Cov.	2.6	2.2	1.9	2.0	-1.6	1.8	2.6	2.8	2.6	3.2	***2.75***	***2.75***
Payout	252%	163%	113%	108%	133%	148%	86.1%	72.7%	103%	73.0%	***63.6%***	***71.4%***
Std. Dev.	25.8%	24.9%	24.1%	20.7%	15.0%	13.8%	12.1%	17.6%	19.7%	11.2%	***19.0%***	***19.0%***

Deutsche Telekom's gross profits to assets ratio is far better than many other sectors of the stock market, but it is actually quite weak relative to its other major global peer AT&T. For context, AT&T has reported a gross profit to assets ratio above 50% throughout the last decade. Still, Deutsche Telekom appears to be a high-quality investment. The company has undisputed leadership within the European telecommunications market and is investing aggressively to maintain this position. Last year, the company invested a record €12.1 billion (US$14.9 billion) to build out its telecommunications network. Deutsche Telekom also operates with a conservatively-financed balance sheet. The company has an investment-grade BBB+ credit rating from Standard & Poor's, which allows it to raise capital at attractive rates to continue investing in its future as a business.

Final Thoughts & Recommendation

Deutsche Telekom provides exactly what most investors in the telecommunications sector are looking for: stability, cash flow, and a high dividend payout. Moreover, the company's global business model combined with its part ownership of T-Mobile gives it exposure to telecommunications markets worldwide. Deutsche Telekom has expected returns in the low double-digit, but it is still not the most compelling investment opportunity in its sector (AT&T has likely earned that title). Because of this, the company fails to earn a buy recommendation from Sure Dividend at current prices, although its remains a strong hold for existing stockholders. Moreover, investors who are already overweight AT&T stock may want to spread their telecommunications exposure to Deutsche Telekom in the name of diversification.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.