



Telephone & Data Systems (TDS)

Updated August 21st, 2018 by Aristofanis Papadatos

Key Metrics

Current Price: \$31	5 Year CAGR Estimate: 6.8%	Volatility Percentile: 77.8%
Fair Value Price: \$34	5 Year Growth Estimate: 3.0%	Momentum Percentile: 41.6%
% Fair Value: 92%	5 Year Valuation Multiple Estimate: 1.7%	Valuation Percentile: 78.0%
Dividend Yield: 2.1%	5 Year Price Target \$39	Total Return Percentile: 43.5%

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 (~78%). TDS started in 1969 as a collection of 10 rural telephone companies. Today the company has a market cap of \$3.4 billion and more than \$5 billion in sales in the last 12 months.

In early August, TDS reported (8/3/18) its financial results for the second quarter of fiscal 2018. While the revenue increased only 1% compared to last year's quarter, the earnings per share more than tripled (\$0.29 vs. \$0.09) and exceeded the analysts' estimates (\$0.21) by a wide margin. The great results of TDS resulted from the impressive performance of U.S. Cellular, which drove high customer loyalty and managed to reduce its operating expenses even amid higher data traffic. Moreover, U.S. Cellular continues to make enhancements to its high-performing network. TDS owns a large share of U.S. Cellular and essentially relies on this company to achieve growth, as its other businesses, namely residential wireline, broadband and voice connections, have failed to grow in recent years.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$0.74	\$1.63	\$1.25	\$1.68	\$0.75	\$1.29	\$1.26	\$1.98	\$0.39	\$0.53	\$1.25	\$1.25
BPS¹	\$30.88	\$32.81	\$33.75	\$33.60	\$37.16	\$37.85	\$36.39	\$37.86	\$37.67	\$38.42	\$39.70	\$46.00
DPS	\$0.38	\$0.40	\$0.41	\$0.43	\$0.49	\$0.51	\$0.54	\$0.56	\$0.59	\$0.62	\$0.64	\$0.93

TDS has exhibited a markedly volatile performance record. During the last decade, its earnings per share have declined approximately 3.3% per year. On the other hand, the company has grown its earnings per share by 50% in the first half of this year, from \$0.42 to \$0.63. Therefore, given the strong momentum of U.S. Cellular, we expect TDS to earn about \$1.25 this year.

While the earnings trend has been volatile, the book value per share has grown by 2.2% per year over the last decade. The book value trend is much more consistent. We are projecting 3% growth of book value going forward.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/B	1.32	0.91	0.99	0.87	0.64	0.67	0.70	0.72	0.73	0.73	0.78	0.85
Avg. Yld.	1.0%	1.4%	1.4%	1.6%	2.1%	2.0%	2.1%	2.1%	2.1%	2.2%	2.1%	2.4%

Due to the volatility in the company's earnings, we believe that the best way to assess the valuation of TDS is by looking at its price-to-book ratio. Its 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. As the stock is now trading at a price-to-book ratio of 0.78, it is likely to enjoy a 1.7% annualized gain thanks to expansion of its valuation over the next five years.

¹ Book-value-per-share

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.

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%	29.0%	30.0%
Debt/A	50.8%	50.5%	50.6%	51.7%	53.5%	53.7%	55.7%	56.2%	56.1%	54.1%	52.8%	53.0%
Int. Cov.	2.9	4.4	3.8	4.4	3.7	4.4	-0.4	4.2	1.6	0.3	1.1	3.0
Payout	51.4%	24.5%	32.8%	25.6%	65.3%	39.5%	42.9%	28.3%	151%	117%	51.2%	74.4%
Std. Dev.	68.4%	38.8%	25.6%	38.4%	31.8%	26.7%	28%	28.4%	26.7%	25.8%	27.4%	33.9%

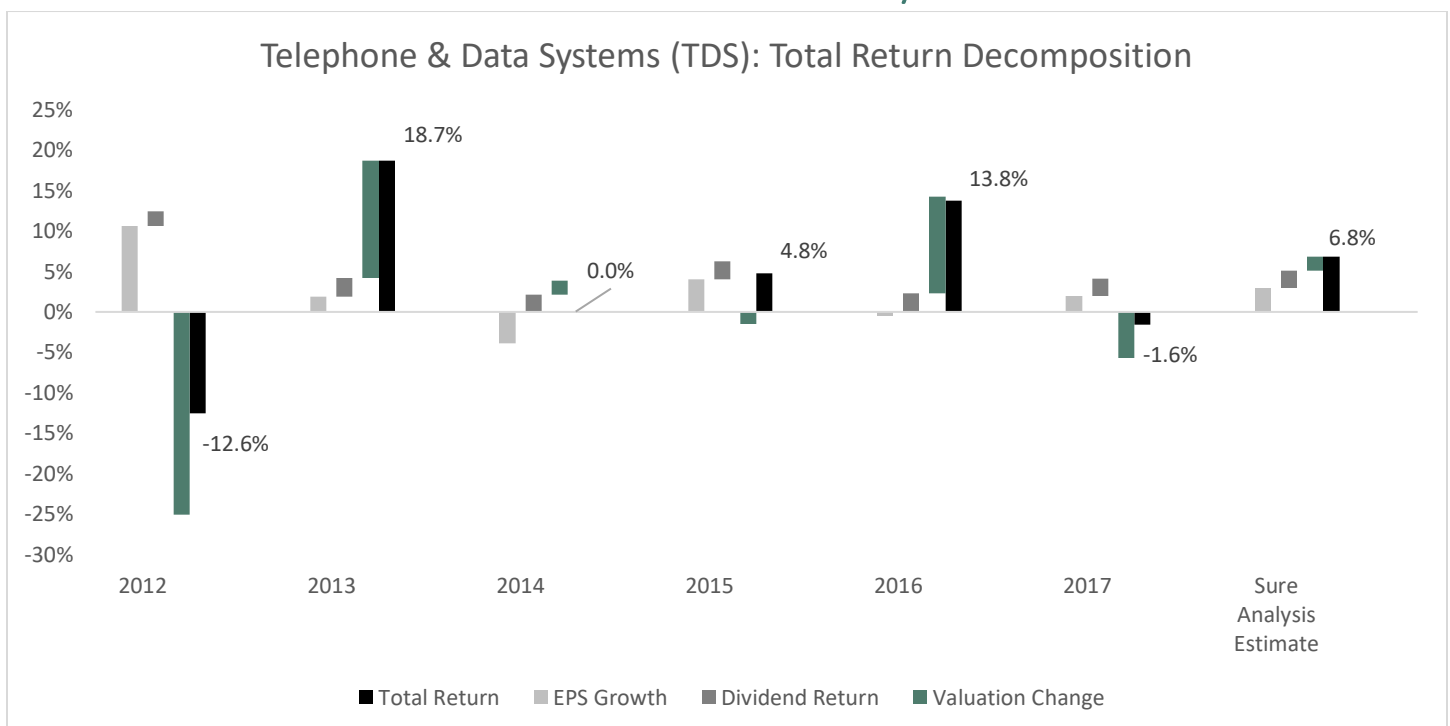
TDS has increased its dividend for 44 consecutive years. The company last raised its dividend by 3.2% in February. It has grown its dividend by 4.7% per year on average over the past 10 years. However, its current 2.1% dividend yield is only slightly above the yield of S&P. Moreover, the company has exhibited pronounced volatility in its results. This is a very negative feature, which investors should not underestimate. When a stock has such unpredictable performance, it should be viewed as speculative. It is not accidental that Warren Buffett considers a consistent growth record as one of the most important attributes of a stock.

Another risk factor of TDS is its strong dependence on U.S. Cellular. As the latter generates the vast majority of the revenues and earnings of TDS and is currently its only growth driver, any headwind that may show up in the way of U.S. Cellular will have a severe impact on TDS.

Final Thoughts & Recommendation

TDS has greatly increased its earnings this year thanks to the solid performance of U.S. Cellular. In fact, the company looks poised to more than double its earnings per share this year. Moreover, it can offer a 6.8% average annual return over the next five years thanks to 3.0% growth of its book value, its 2.1% dividend and a 1.7% annualized expansion of its valuation level. However, its extremely volatile performance record renders the stock too risky. Moreover, the stock has offered a negative total return during the last decade while it has traded within a markedly tight range during this period. As a result, we advise investors to avoid this stock. Investors who want to gain exposure to this sector should probably select a different stock, with the industry giant AT&T (T) being the most obvious example. AT&T offers a higher yield, greater safety, and significantly higher expected total returns.

Total Return Breakdown by Year



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