



# TELUS Corporation (TU)

Updated August 21<sup>st</sup>, 2018 by Nick McCullum

## Key Metrics

<b>Current Price:</b> \$49	<b>5 Year CAGR Estimate:</b> 3.3%	<b>Volatility Percentile:</b> XX.X%
<b>Fair Value Price:</b> \$39	<b>5 Year Growth Estimate:</b> 3.5%	<b>Momentum Percentile:</b> XX.X%
<b>% Fair Value:</b> 126%	<b>5 Year Valuation Multiple Estimate:</b> -4.5%	<b>Valuation Percentile:</b> XX.X%
<b>Dividend Yield:</b> 4.3%	<b>5 Year Price Target</b> \$46	<b>Total Return Percentile:</b> XX.X%

## Overview & Current Events

TELUS Corporation is one of the 'big three' Canadian telecommunications companies along with BCE, Inc. (BCE) and Rogers Communications (RCI). TELUS is focused in Western Canada and provides a full range of communication products and services through two business segments: Wireline and Wireless. TELUS is cross-listed on the Toronto Stock Exchange and the New York Stock Exchange, where it trades under the tickers 'T' and 'TU', respectively. TELUS reports financial results in Canadian dollars. To remove the impact of foreign exchange fluctuations, all figures in this report are in Canadian dollars and refer to the listing on the Toronto Stock Exchange, although the investment thesis is identical for both cross-listed securities.

In early August, TELUS reported (8/3/18) financial results for the second quarter of fiscal 2018. In the quarter, the company generated organic revenue growth of 5.8% and EBITDA growth of 5.0%. Free cash flow of \$329 million was very strong and expanded by 27% over the same period a year ago. TELUS' revenue growth did not translate to its bottom line due to a number of factors, including higher operating expenses (including employee benefits expense from recent business acquisitions), higher depreciation and amortization expenses, and increased financing costs. Both GAAP and adjusted earnings-per-share were flat over last year's comparable figure. TELUS' second-quarter earnings release was positively received by the markets and its stock continues to trade about 4% higher than its levels prior to the earnings release.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$1.76	\$1.57	\$1.61	\$1.87	\$2.01	\$2.01	\$2.31	\$2.29	\$2.06	\$2.46	<b>\$2.50</b>	<b>\$2.97</b>
<b>DPS</b>	\$0.91	\$0.95	\$0.98	\$1.08	\$1.19	\$1.32	\$1.48	\$1.64	\$1.80	\$1.95	<b>\$2.05</b>	<b>\$2.65</b>

TELUS pays out the majority of its earnings-per-share as dividend payments, which leaves little in the way of retained earnings to invest for growth. Still, the company has managed to grow its earnings-per-share at about 3.5% per year over the last decade. We believe that a similar rate of growth is feasible for TELUS Corporation moving forward.

In terms of dividend payments, TELUS has a publicly-communicated target of 7%-10% dividend growth through 2019. While we believe that dividend growth will continue to outpace earnings growth beyond 2019, we do not expect TELUS to be capable of maintaining a 7%+ dividend growth rate for extended periods of time.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	11.9	10.5	12.6	13.8	15.1	17.2	17.1	18.5	20.1	18.3	<b>19.5</b>	<b>15.5</b>
<b>Avg. Yld.</b>	4.4%	5.8%	4.8%	4.2%	3.9%	3.8%	3.7%	3.9%	4.3%	4.3%	<b>4.3%</b>	<b>5.8%</b>

TELUS has traded at an average price-to-earnings ratio of 15.5 over the last decade, which we believe represents an approximation of fair value for this Canadian telecommunications corporation. Using our 2018 earnings-per-share estimate, the company is trading at a price-to-earnings ratio of 19.5 today. TELUS is noticeably overvalued at current prices. If shares were to revert to their 10-year average valuation multiples over a 5-year holding period, this would reduce investors' total returns by 4.5% per year during this time period.

*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
<b>GP/A</b>	33.7%	32.9%	28.1%	28.1%	29.5%	29.6%	28.5%	26.1%	25.6%	29.5%	<b>28.0%</b>	<b>28.0%</b>
<b>Int. Cov.</b>	4.4	3.3	3.7	5.1	5.3	4.9	5.2	5.1	4.3	4.5	<b>4.5</b>	<b>4.5</b>
<b>Debt/A</b>	62.6%	60.6%	60.3%	62.3%	62.4%	62.8%	67.9%	70.9%	71.4%	72.0%	<b>70.0%</b>	<b>70.0%</b>
<b>Std. Dev.</b>	25.3%	22.3%	13.0%	12.1%	7.5%	18.8%	14.9%	11.7%	12.7%	8.4%	<b>15.0%</b>	<b>15.0%</b>
<b>Payout</b>	51.7%	60.5%	60.9%	57.8%	59.2%	65.7%	64.1%	71.6%	87.4%	79.3%	<b>82.0%</b>	<b>89.2%</b>

TELUS scores reasonably well on all of our quality metrics. The company's gross profits to assets ratio is not quite as high as the leading global telecommunications company AT&T (whose ratio has exceeded 50% for more than a decade). Still, TELUS typically covers its interest expense many times over with operating income, and liabilities comprise less than three-quarters of its aggregate balance sheet. At the security level, TELUS has traded with remarkable little stock price volatility since the 2007-2009 financial crisis, and its conservative dividend payout ratio gives it some room to continue hiking its dividend in the event that earnings growth stalls temporarily.

Qualitatively, TELUS' main competitive advantage comes from being an entrenched player in a capital-intensive and highly regulated industry. Indeed, accordingly to Canada's telecommunications regulator – the Canadian Radio-television and Telecommunications Commissions (CRTC) – the Top 5 telecommunications providers gather 85% of the industry's revenues. This discourages potential competitors and makes TELUS' existing presence extremely powerful.

### Final Thoughts & Recommendation

TELUS Corporation is one of Canada's largest telecommunications providers. The company's attractive dividend yield and overall business stability make it attractive for conservative, income-seeking investors.

However, TELUS is currently trading at a valuation that we find difficult to stomach. Valuation contraction will likely introduce a meaningful headwind to this stock's future returns. Accordingly, we recommend that investors sell TELUS and reinvest the proceeds into more attractive opportunities within the telecommunications sector. More specifically, domestic telecommunications company AT&T (T) is profoundly undervalued and has many of the qualitative characteristics that TELUS' investors find appealing.

### Total Return Breakdown by Year

