CenturyLink Inc. (CTL)

Updated November 14th, 2018 by Josh Arnold

Key Metrics

Current Price:	$19	**5 Year CAGR Estimate:**	13.4%	**Volatility Percentile:**	89.3%
Fair Value Price:	$15	**5 Year Growth Estimate:**	6.8%	**Momentum Percentile:**	91.7%
% Fair Value:	128%	**5 Year Valuation Multiple Estimate:**	-4.8%	**Growth Percentile:**	61.1%
Dividend Yield:	11.4%	**5 Year Price Target**	$20	**Valuation Percentile:**	17.0%
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Total Return Percentile:**	80.9%

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 exponentially into what has become CenturyLink, which serves customers in 60 different countries today. It has a $20 billion market capitalization and should produce $23 billion in revenue this year.

CenturyLink reported Q3 earnings on 11/8/18 and results were somewhat mixed as revenue was light but profitability increased meaningfully. Total revenue fell 3.6% during the quarter as every reporting segment saw at least a 2.5% decline in the top line. Total subscribers fell slightly year-over-year as CenturyLink continues to have a tough time growing its business. In particular, voice and collaboration revenue, which is CenturyLink's third largest segment, saw 8.4% deterioration in its top line. On the plus side, adjusted EBITDA margin increased from 35.5% to 39.3% year-over-year and free cash flow nearly doubled to $1.163 billion. The company achieved annualized run rate synergies from the Level 3 merger of $790 million in Q3 and management said it expected that to move to $850 million by the end of the year. This improvement in margins is sorely needed given the struggles with the top line and it certainly appears CenturyLink is well on its way to achieving its goals.

The company boosted its free cash flow outlook for the year, stating the new range is now $4 to $4.2 billion against a former range that was $400 million lower. It similarly boosted its after-dividend free cash flow forecast to $1.7 to $1.9 billion, also boosting that range by $400 million. The dividend is enormously important to CenturyLink shareholders and while its business is far from perfect, the strong free cash flow forecast certainly bodes well for the company's ability to continue to pay its 11%+ yield. We've reiterated our estimates for this year and 2023 after the Q3 report, but note that the dividend appears to be meaningfully safer than it was as a result of the boosted free cash flow guidance.

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**
Shares	100	299	305	619	626	584	569	544	547	1,069	***1,100***	***1,100***

CenturyLink has struggled in recent years with competition as well as profitability. The Level 3 acquisition has seen the company's share count double in the past couple of years. In addition, it took on another $13 billion in debt with the transaction onto a balance sheet that was already in poor shape.

That said, we see 6.8% annual growth going forward as it has some catalysts for earnings expansion. Revenue should continue to move higher from the Level 3 merger. Management believes it can achieve roughly $1 billion in annual operating savings within three years, as we saw in Q3. It would also allow for CenturyLink to potentially reduce some of its considerable debt, which is growing ever more expensive to service.

The dividend is a hot issue for CenturyLink shareholders as it has been stagnant since a cut in 2013. We do not 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.

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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	***16.3***	***12.8***
Avg. Yld.	4.6%	9.1%	7.8%	7.5%	7.4%	6.2%	5.9%	6.9%	7.7%	9.8%	***11.4%***	***10.5%***

CenturyLink's volatile price-to-earnings ratio stands at 16.3 now, which is well in excess of its historical norm at 12.8 and as a result, we see a 4.8% headwind annually. 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%**

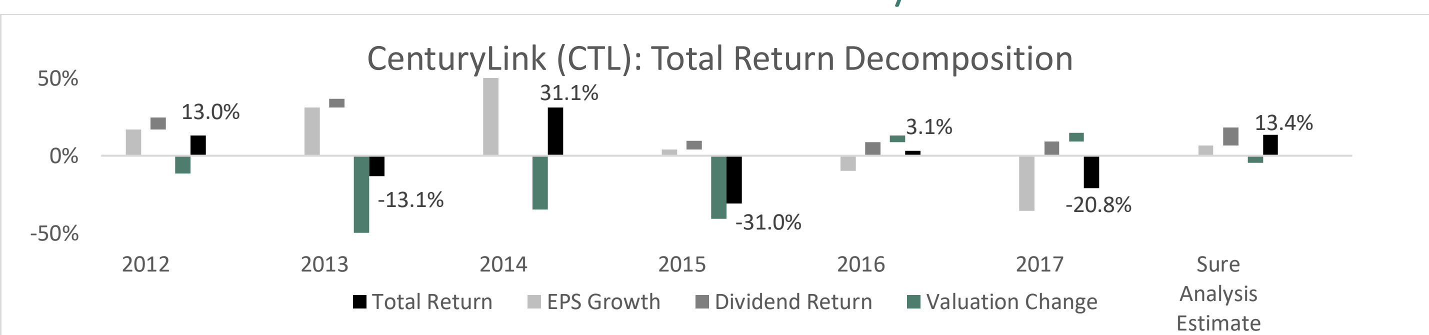
CenturyLink's quality metrics have largely deteriorated in the past decade, which is no surprise given how earnings and the stock have performed. Gross margins continue to fall, and we see that trend continuing, although losses should be slight. Debt continues to be a problem, but its debt-to-asset ratio is actually reasonable at about 70%; we do see some upside here as it 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 will not be covered by earnings, but it is covered well by free cash flow.

CenturyLink's competitive advantage is in its diversified model as well as its tremendous size and geographic reach. It 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

CenturyLink is a stock that is trading well in excess of fair value but that offers decent growth potential and an enormous yield. We see total returns of 13.4% going forward, consisting entirely of the 11.4% current yield, which will be partially offset by the combination of 6.8% earnings growth and a 4.8% headwind from the valuation. The dividend looks safe for now and may be good enough for income investors but keep in mind this stock is not for the risk-averse. This is a high-risk, high-reward situation with many variables so more speculative investors may find it attractive here. CenturyLink earns a sell recommendation from Sure Dividend at current prices due to the high valuation and elevated risk.

Total Return Breakdown by Year



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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.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	2600	4974	7042	15351	18376	18095	18031	17900	17470	17656
Gross Profit	1644	3222	4498	9026	10737	10588	10185	10122	9696	9453
Gross Margin	63.2%	64.8%	63.9%	58.8%	58.4%	58.5%	56.5%	56.5%	55.5%	53.5%
SG&A Exp.	399	1014	1004	2975	3244	3502	3347	3354	3447	3508
D&A Exp.	524	975	1434	4026	4780	4541	4428	4189	3916	3936
Operating Profit	721	1233	2060	2025	2713	2545	2410	2579	2333	2009
Operating Margin	27.7%	24.8%	29.3%	13.2%	14.8%	14.1%	13.4%	14.4%	13.4%	11.4%
Net Profit	366	647	948	573	777	-239	772	878	626	1389
Net Margin	14.1%	13.0%	13.5%	3.7%	4.2%	-1.3%	4.3%	4.9%	3.6%	7.9%
Free Cash Flow	418	817	1181	1790	3146	2511	2141	2281	1627	772
Income Tax	194	302	583	375	473	463	338	438	394	-849

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	8254	22563	22038	56044	53940	51787	49103	47604	47017	75611
Cash & Equivalents	243	162	173	128	211	168	128	126	222	551
Accounts Receivable	216	686	713	1768	1782	1862	1821	1789	1882	2245
Inventories	9	36	33	107	125	167	132	144	134	128
Goodwill & Int. Ass.	4803	12342	12140	32214	30597	28411	27295	26225	23978	43248
Total Liabilities	5086	13096	12391	35217	34651	34596	34080	33544	33618	52120
Accounts Payable	135	395	300	1400	1207	1111	1226	968	1179	1555
Long-Term Debt	3315	7754	7328	21836	20605	20966	20503	20225	19688	37726
Shareholder's Equity	3163	9461	9641	20827	19289	17191	15023	14060	13399	23491
D/E Ratio	1.05	0.82	0.76	1.05	1.07	1.22	1.36	1.44	1.47	1.61

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	4.4%	4.2%	4.3%	1.5%	1.4%	-0.5%	1.5%	1.8%	1.3%	2.3%
Return on Equity	11.1%	10.3%	9.9%	3.8%	3.9%	-1.3%	4.8%	6.0%	4.6%	7.5%
ROIC	5.7%	5.5%	5.5%	1.9%	1.9%	-0.6%	2.1%	2.5%	1.9%	2.9%
Shares Out.	100	299	305	619	626	584	569	544	547	1,069
Revenue/Share	25.35	24.99	23.37	28.74	29.53	30.11	31.65	32.25	32.31	28.08
FCF/Share	4.07	4.11	3.92	3.35	5.06	4.18	3.76	4.11	3.01	1.23

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.