



Telephone & Data Systems (TDS)

Updated November 6th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	\$34	5 Year CAGR Estimate:	3.4%	Volatility Percentile:	78.9%
Fair Value Price:	\$34	5 Year Growth Estimate:	1.5%	Momentum Percentile:	84.2%
% Fair Value:	100%	5 Year Valuation Multiple Estimate:	0.0%	Growth Percentile:	3.9%
Dividend Yield:	1.9%	5 Year Price Target	\$37	Valuation Percentile:	50.5%
Dividend Risk Score:	A	Retirement Suitability Score:	B	Total Return Percentile:	12.1%

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 (~77%). TDS started in 1969 as a collection of 10 rural telephone companies. Today the company has a market cap of \$3.8 billion and slightly more than \$5 billion in sales in the last 12 months.

In early November, TDS reported (11/2/18) its financial results for the third quarter of fiscal 2018. The company grew its revenue by 4% thanks to the 4% revenue growth of U.S. Cellular, which exhibited increased inbound roaming, higher device sales and higher postpaid average revenue per user. As TDS did not incur the non-recurring charges of last year, it switched from a loss of \$1.64 per share in Q3-2017 to a profit of \$0.41 per share in Q3-2018. Thanks to the strong performance of U.S. Cellular and reduced operating expenses, TDS smashed the analysts' earnings-per-share consensus of \$0.24 and the stock jumped 14% on the day of its earnings release. TDS has an 83% stake in U.S. Cellular and essentially relies on this stake 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	\$40.00	\$43.00
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
Shares	122.0	115.1	113.0	117.9	107.9	108.8	107.9	109.0	110.0	111.0	114.0	115.0

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 more than doubled its adjusted earnings-per-share in the first nine months of this year, from \$0.50 to \$1.04. Therefore, given the strong momentum of U.S. Cellular, we expect TDS to earn about \$1.25 per share this year.

While the earnings trend has been volatile, book value per share has grown by 2.2% per year over the last decade. The book value trend is much more consistent. As TDS distributes half of its earnings in dividends, we are projecting a book value per share around \$43 by 2023 for a 1.5% average annual growth of book value over the next five years.

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	0.85	0.85
Avg. Yld.	1.0%	1.4%	1.4%	1.6%	2.1%	2.0%	2.1%	2.1%	2.1%	2.2%	1.9%	2.5%

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. As TDS has rallied 13% since its latest earnings release, its price-to-book ratio has risen to 0.85,

¹ Book-value-per-share

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which is very close to its 10-year average of 0.83. As we believe that a price-to-book ratio around 0.85 represents fair value for TDS, we do not expect meaningful gains from a change in its valuation level over the next five years.

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%	53.0%	53.0%
Int. Cov.	2.9	4.4	3.8	4.4	3.7	4.4	-0.4	4.2	1.6	0.3	1.0	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%

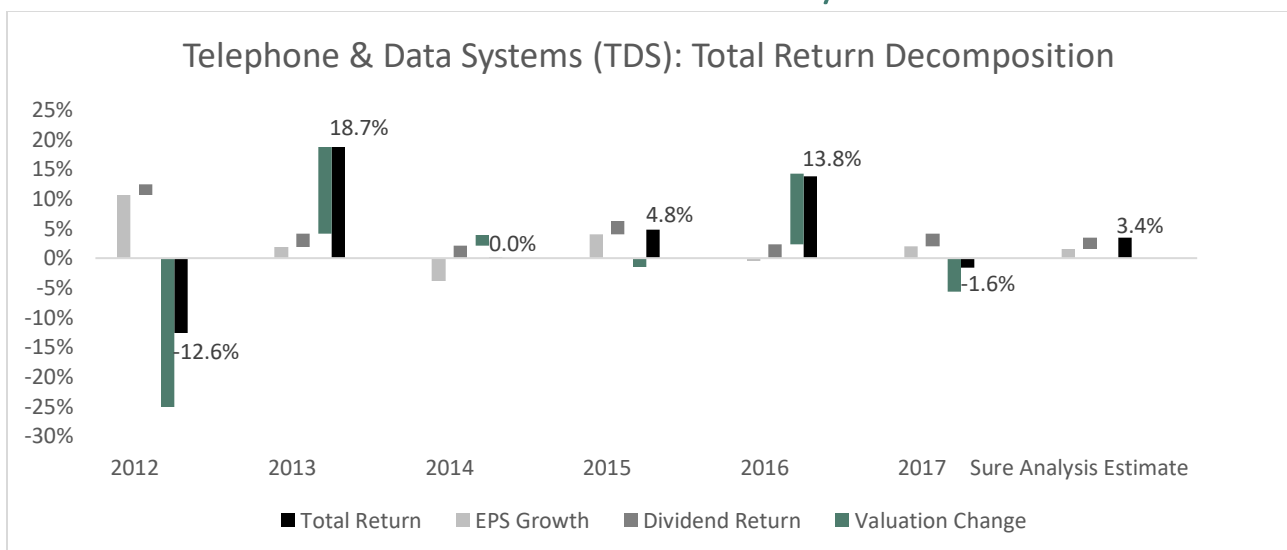
TDS has raised its dividend for 44 consecutive years. It has grown its dividend by 4.7% per year on average over the past 10 years. However, its current 2.1% dividend yield is only slightly above the yield of S&P. Moreover, the company has exhibited pronounced volatility in its results. This is a negative 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, which operates in a very competitive market. As U.S. Cellular 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. However, due to its recent rally, it is likely to offer just a 3.4% average annual return over the next five years. We have been somewhat conservative in our forecast due to the extremely volatile performance record, which renders the stock too risky. On the other hand, 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 risky 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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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	5092	5020	4987	5180	5345	4901	5009	5210	5155	5044
Gross Profit	3238	3149	3062	3130	3073	2676	2498	2795	2726	2685
Gross Margin	63.6%	62.7%	61.4%	60.4%	57.5%	54.6%	49.9%	53.6%	52.9%	53.2%
SG&A Exp.	1921	1964	1998	2002	2034	1948	1865	1781	1759	1686
D&A Exp.	N/A	N/A	756	766	814	1018	837	844	850	844
Operating Profit	567	436	308	362	225	-290	-204	170	117	155
Operating Margin	11.1%	8.7%	6.2%	7.0%	4.2%	-5.9%	-4.1%	3.3%	2.3%	3.1%
Net Profit	94	189	145	201	82	142	-136	219	43	153
Net Margin	1.8%	3.8%	2.9%	3.9%	1.5%	2.9%	-2.7%	4.2%	0.8%	3.0%
Free Cash Flow	-275	431	337	284	110	-389	-404	-11	146	91
Income Tax	30	134	95	114	74	126	-5	172	40	-279

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	7652	7612	7763	8201	8624	8904	8854	9422	9446	9295
Cash & Equivalents	777	671	368	563	740	830	472	985	900	619
Accounts Receivable	377	515	513	394	410	552	549	705	753	861
Inventories	122	157	116	130	161	245	274	158	151	145
Goodwill & Int. Ass.	2183	2177	2219	2342	2336	2456	2534	2901	2938	3020
Total Liabilities	3235	3184	3301	3598	3968	4234	4399	4718	4696	4403
Accounts Payable	320	347	344	365	377	496	387	349	365	368
Long-Term Debt	1637	1495	1502	1531	1723	1722	1942	2454	2445	2457
Shareholder's Equity	3767	3764	3814	3962	4012	4118	3926	4126	4144	4269
D/E Ratio	0.43	0.40	0.39	0.39	0.43	0.42	0.49	0.59	0.59	0.58

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	1.1%	2.5%	1.9%	2.5%	1.0%	1.6%	-1.5%	2.4%	0.5%	1.6%
Return on Equity	2.4%	5.0%	3.8%	5.2%	2.1%	3.5%	-3.4%	5.4%	1.0%	3.6%
ROIC	1.5%	3.2%	2.4%	3.3%	1.3%	2.2%	-2.1%	3.2%	0.6%	2.1%
Shares Out.	122.0	115.1	113.0	117.9	107.9	108.8	107.9	109.0	110.0	111.0
Revenue/Share	40.29	42.15	45.13	47.48	49.07	44.91	46.38	47.36	46.44	45.04
FCF/Share	-2.18	3.62	3.05	2.60	1.01	-3.57	-3.74	-0.10	1.32	0.81

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

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