



TELUS Corporation (TU)

Updated November 12th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	\$46	5 Year CAGR Estimate:	5.4%	Volatility Percentile:	1.1%
Fair Value Price:	\$40	5 Year Growth Estimate:	3.5%	Momentum Percentile:	42.5%
% Fair Value:	114%	5 Year Valuation Multiple Estimate:	-2.6%	Growth Percentile:	17.5%
Dividend Yield:	4.5%	5 Year Price Target	\$48	Valuation Percentile:	25.4%
Dividend Risk Score:	D	Retirement Suitability Score:	B	Total Return Percentile:	21.7%

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 November, TELUS reported (11/8/18) financial results for the third quarter of fiscal 2018. In the quarter, the company grew its revenue by 11%, mostly thanks to growth in wireless network revenue and wireline data services revenue. The company added 187,000 new customers and grew its earnings-per-share by 9% over last year. As a result, it exceeded analysts' estimates on both lines.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$1.76	\$1.57	\$1.61	\$1.87	\$2.01	\$2.01	\$2.31	\$2.29	\$2.06	\$2.46	\$2.60	\$3.09
DPS	\$0.91	\$0.95	\$0.98	\$1.08	\$1.19	\$1.32	\$1.48	\$1.64	\$1.80	\$1.95	\$2.05	\$2.65
Shares	643.3	635.4	644.7	649.7	651.9	623.4	609.0	594.3	590.0	595.0	596.0	570.0

TELUS pays out the majority of its earnings-per-share as dividends, 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. Thanks to the positive surprise in Q3 results, we have revised our earnings-per-share estimate for the year from \$2.50 to \$2.60.

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
Avg. P/E	11.9	10.5	12.6	13.8	15.1	17.2	17.1	18.5	20.1	18.3	17.7	15.5
Avg. Yld.	4.4%	5.8%	4.8%	4.2%	3.9%	3.8%	3.7%	3.9%	4.3%	4.3%	4.5%	5.5%

TELUS has traded at an average P/E ratio of 15.5 over the last decade, which we believe represents an approximation of fair value for this Canadian telecommunications corporation. In our last research report, in August, we stated that the stock was overvalued. As the stock has lost 6% since then, it has become more reasonably valued but it is still trading at a P/E ratio of 17.7, which is higher than its historical average. If the stock reverts to its average valuation level over the next five years, it will incur a 2.6% annualized drag due to P/E contraction.

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Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	33.7%	32.9%	28.1%	28.1%	29.5%	29.6%	28.5%	26.1%	25.6%	29.5%	24.0%	28.0%
Int. Cov.	4.4	3.3	3.7	5.1	5.3	4.9	5.2	5.1	4.3	4.5	4.0	4.5
Debt/A	62.6%	60.6%	60.3%	62.3%	62.4%	62.8%	67.9%	70.9%	71.4%	72.0%	70.0%	70.0%
Std. Dev.	25.3%	22.3%	13.0%	12.1%	7.5%	18.8%	14.9%	11.7%	12.7%	8.4%	15.0%	15.0%
Payout	51.7%	60.5%	60.9%	57.8%	59.2%	65.7%	64.1%	71.6%	87.4%	79.3%	78.8%	85.8%

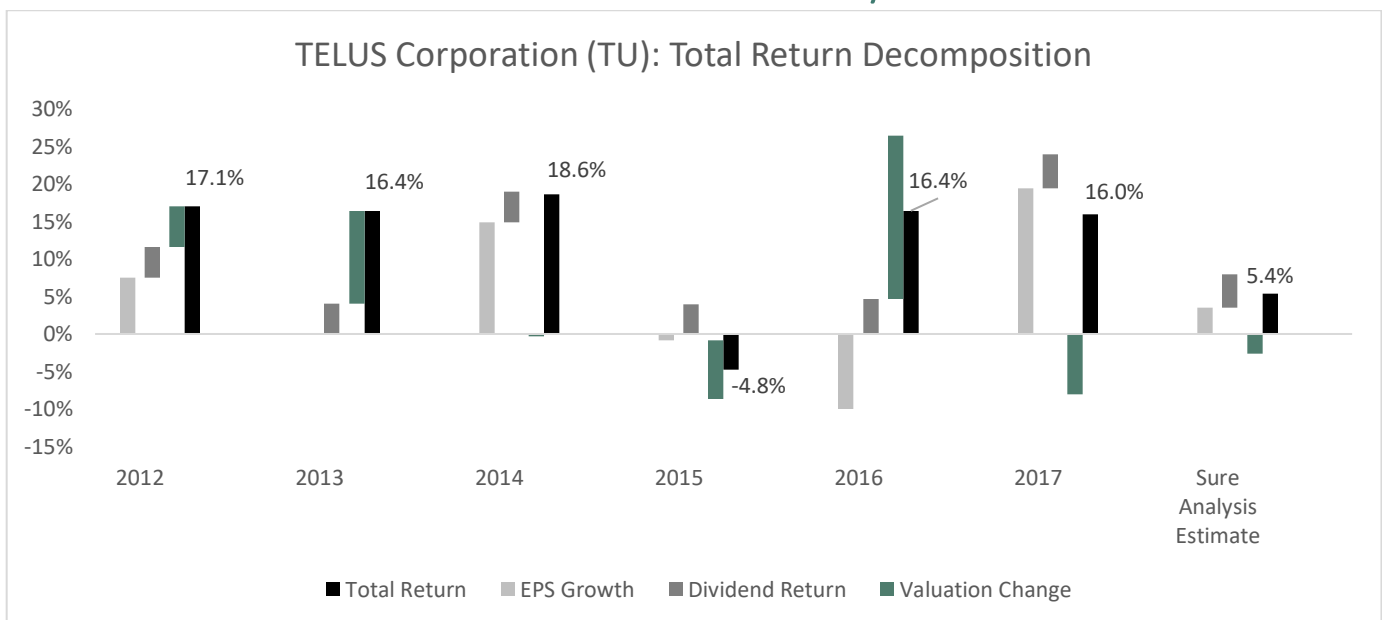
TELUS scores reasonably well on all of our quality metrics. The company's gross profit to assets ratio is not quite as high as the leading global telecommunications company AT&T (whose ratio has exceeded 50% for more than a decade). Still, TELUS typically covers its interest expense many times over with operating income, and liabilities comprise less than three-quarters of its aggregate balance sheet. At the security level, TELUS has traded with remarkably 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 is a competitive advantage for TELUS.

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. Although TELUS has corrected 6% since our last report, the stock still has a rich valuation and is thus likely to offer mediocre returns in the years ahead. As a result, we rate TELUS as a hold. Investors looking for telecommunications exposure will likely find AT&T (T) and Verizon (VZ) more appealing.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	9653	9606	9742	10325	10852	11336	11927	12430	12725	13202
Gross Profit	6418	6328	5506	5599	6032	6374	6628	6898	7094	7267
Gross Margin	66.5%	65.9%	56.5%	54.2%	55.6%	56.2%	55.6%	55.5%	55.7%	55.0%
SG&A Exp.	2580	2647	1906	1893	2242	2424	2487	2708	2939	2595
D&A Exp.	1713	1722	1741	1810	1865	1803	1834	1909	2047	2169
Operating Profit	2125	1959	1909	1968	1983	2202	2362	2329	2144	2535
Operating Margin	22.0%	20.4%	19.6%	19.1%	18.3%	19.4%	19.8%	18.7%	16.8%	19.2%
Net Profit	1128	1002	1048	1215	1204	1294	1425	1382	1223	1460
Net Margin	11.7%	10.4%	10.8%	11.8%	11.1%	11.4%	11.9%	11.1%	9.6%	11.1%
Free Cash Flow	78	801	949	683	1269	1144	-137	-1014	322	866
Income Tax	436	203	335	376	416	474	501	524	426	553

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	19021	19219	19624	19931	20445	21566	23217	26406	27729	29548
Cash & Equivalents	N/A	41	17	46	107	336	60	223	432	509
Acc. Receivable	966	694	1203	1253	1331	1295	1290	1275	1294	1321
Inventories	397	270	283	353	350	326	320	360	318	378
Goodwill & Int.	8730	8720	9724	9814	9883	10268	11554	13746	14151	14875
Total Liabilities	11913	11644	11843	12418	12759	13551	15763	18734	19793	21285
Accounts Payable	441	1385	448	406	423	458	458	476	578	717
Long-Term Debt	7111	6172	6456	6978	6658	7893	9410	12138	13031	13760
Total Equity	7085	7554	7759	7513	7686	8015	7454	7672	7917	8221
D/E Ratio	1.00	0.82	0.83	0.93	0.87	0.98	1.26	1.58	1.65	1.67

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	6.3%	5.2%	5.4%	6.1%	6.0%	6.2%	6.4%	5.6%	4.5%	5.1%
Return on Equity	16.1%	13.7%	13.7%	15.9%	15.8%	16.5%	18.4%	18.3%	15.7%	18.1%
ROIC	8.5%	7.2%	7.5%	8.5%	8.4%	8.6%	8.7%	7.5%	6.0%	6.8%
Shares Out.	643.3	635.4	644.7	649.7	651.9	623.4	609.0	594.3	590.0	595.0
Revenue/Share	14.99	15.10	15.17	15.84	16.57	17.63	19.30	20.58	21.46	22.26
FCF/Share	0.12	1.26	1.48	1.05	1.94	1.78	-0.22	-1.68	0.54	1.46

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

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