



# CenturyLink Inc. (CTL)

Updated February 14<sup>th</sup>, 2019 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$13	<b>5 Year CAGR Estimate:</b>	11.4%	<b>Volatility Percentile:</b>	87.9%
<b>Fair Value Price:</b>	\$12	<b>5 Year Growth Estimate:</b>	5.0%	<b>Momentum Percentile:</b>	35.4%
<b>% Fair Value:</b>	107%	<b>5 Year Valuation Multiple Estimate:</b>	-1.3%	<b>Growth Percentile:</b>	34.1%
<b>Dividend Yield:</b>	7.7%	<b>5 Year Price Target</b>	\$15	<b>Valuation Percentile:</b>	32.2%
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Total Return Percentile:</b>	66.8%

## 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 \$14 billion market capitalization and should produce \$22 billion in revenue this year.

CenturyLink reported Q4 earnings on 2/13/19 and results were not only weak, but the company slashed its dividend by more than half. As a result, the stock was down double digits on the report to a low that has not been seen since the 1990s. Total revenue fell 3.8% in Q4 as CenturyLink's recent bout of weakness is showing no signs of ending. Business revenue fell 2.2%, led by a 5.6% decline in the company's Small & Medium segment. Consumer revenue fell 8.3% and Regulatory revenue was off by 6.3%. While revenue was very weak against the year-ago period, the silver lining is that revenue was essentially flat against Q3, so further sequential deterioration has not occurred.

Total consumer broadband subscribers fell less than 1% during the quarter as weakness in the lowest tier of service was mostly offset by strength in the two higher tiers, which are generally accompanied by higher revenue per account.

Lower SG&A costs helped salvage margins and profitability as earnings-per-share came in at \$1.06 on an adjusted basis in Q4, bringing the full-year number to \$1.42.

In what is likely bigger news than the company's earnings, CenturyLink announced it was slashing its dividend from \$2.16 annually to just \$1 per share. The move is intended to alleviate the significant stress the dividend was placing on the company's cash as the dividend had begun to exceed the company's ability to pay it. The new dividend will allow the company to save ~\$1.2 billion in cash each year, which will help it towards reducing leverage. Indeed, management cited leverage as the primary reason for the dividend cut and it announced a new long-term leverage target of 2.75X EBITDA against the old target of 3.25X EBITDA. Today, CenturyLink's leverage is still in excess of 4X EBITDA, so it has some work to do. However, the \$1.2 billion in annual savings from the dividend should help it accelerate that process meaningfully.

We're out with a cautious initial earnings-per-share estimate of \$1.10 for 2019 as we see CenturyLink as continuing to struggle with customer retention. We should note, however, that the company's results have been very volatile recently so we'll be nimble with our estimate as the year progresses.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$3.46	\$3.41	\$1.07	\$1.25	\$1.64	\$2.61	\$2.72	\$2.45	\$1.58	\$1.42	<b>\$1.10</b>	<b>\$1.40</b>
<b>DPS</b>	\$2.80	\$2.90	\$2.90	\$2.90	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	<b>\$1.00</b>	<b>\$1.00</b>
<b>Shares</b>	299	305	619	626	584	569	544	547	1,069	1,067	<b>1,065</b>	<b>1,060</b>

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 5% annual growth going forward as it has some catalysts for earnings expansion. Revenue should continue to move higher from the Level 3 merger. The company has already achieved \$850 million in annual cost saving synergies from the merger, which is two years ahead of schedule. Reduced leverage should help improve margins over

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time as well as less of the company's earnings will be consumed by interest expense. However, recent weakness has caused us to reduce our earnings growth estimate from 6.8% annually to 5%.

The yield is obviously taking center stage for investors as the cut in the dividend was sizable. We do not believe management will raise the payout anytime soon given the aggressive leverage target of 2.75X EBITDA.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	8.9	10.9	36.2	31.4	21.3	14.0	11.6	11.4	13.9	13.3	<b>11.8</b>	<b>11.0</b>
Avg. Yld.	9.1%	7.8%	7.5%	7.4%	6.2%	5.9%	6.9%	7.7%	9.8%	11.4%	<b>7.7%</b>	<b>6.5%</b>

CenturyLink's volatile price-to-earnings ratio stands at 11.8 now. We have reduced our fair value estimate from 12.8 times earnings to 11 given the marked weakness in the company's recent results. We also believe the lower yield will see investors pay less for the stock than they would have in the past. 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 6%.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	54%	85%	--	--	132%	83%	79%	88%	129%	152%	<b>91%</b>	<b>71%</b>

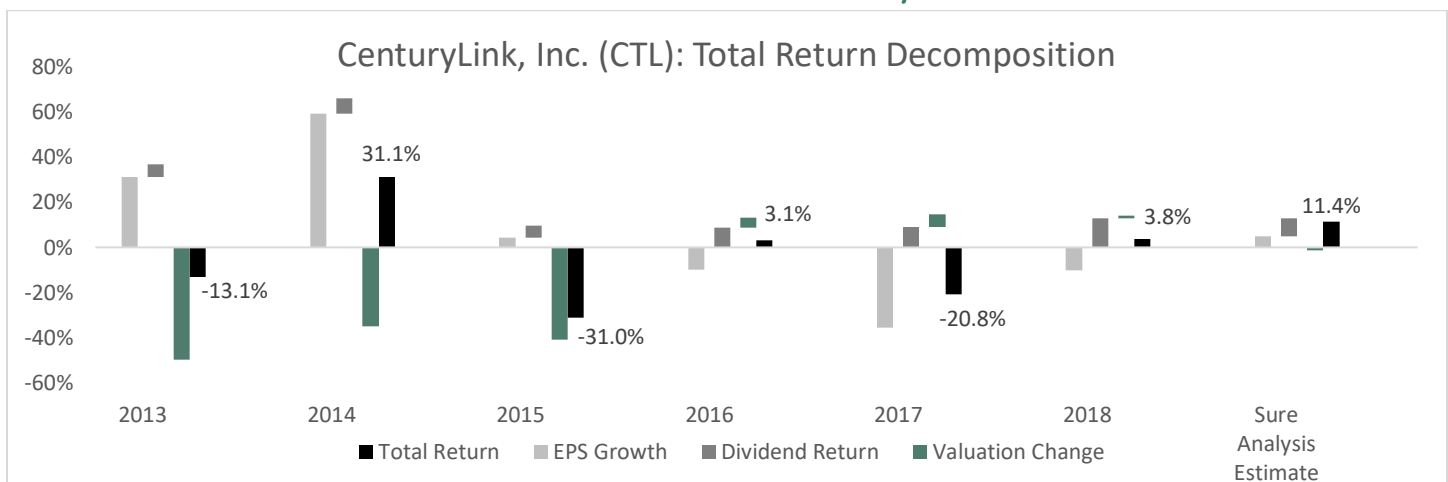
CenturyLink's payout ratio is now back under 100% after the dividend cut, and we expect the dividend will remain at \$1 per share for the foreseeable future. Management has made it clear the priority is reducing leverage, so we see the payout ratio drifting lower over time as earnings grow but the dividend remains steady.

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 in excess of fair value but that offers decent growth potential and an enormous yield. We see total returns of 11.4% going forward, consisting of the 7.7% current yield, 5% earnings growth and a modest 1.3% headwind from the valuation. This remains a high-risk, high-reward situation, particularly in light of the dividend cut. Thus, despite the high projected total returns, we reiterate CenturyLink at a sell rating.

## Total Return Breakdown by Year



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## Income Statement Metrics

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

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	8254	22563	22038	56044	53940	51787	49103	47604	47017	75611
<b>Cash &amp; Equivalents</b>	243	162	173	128	211	168	128	126	222	551
<b>Accounts Receivable</b>	216	686	713	1768	1782	1862	1821	1789	1882	2245
<b>Inventories</b>	9	36	33	107	125	167	132	144	134	128
<b>Goodwill &amp; Int. Ass.</b>	4803	12342	12140	32214	30597	28411	27295	26225	23978	43248
<b>Total Liabilities</b>	5086	13096	12391	35217	34651	34596	34080	33544	33618	52120
<b>Accounts Payable</b>	135	395	300	1400	1207	1111	1226	968	1179	1555
<b>Long-Term Debt</b>	3315	7754	7328	21836	20605	20966	20503	20225	19688	37726
<b>Shareholder's Equity</b>	3163	9461	9641	20827	19289	17191	15023	14060	13399	23491
<b>D/E Ratio</b>	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
<b>Return on Assets</b>	4.4%	4.2%	4.3%	1.5%	1.4%	-0.5%	1.5%	1.8%	1.3%	2.3%
<b>Return on Equity</b>	11.1%	10.3%	9.9%	3.8%	3.9%	-1.3%	4.8%	6.0%	4.6%	7.5%
<b>ROIC</b>	5.7%	5.5%	5.5%	1.9%	1.9%	-0.6%	2.1%	2.5%	1.9%	2.9%
<b>Shares Out.</b>	100	299	305	619	626	584	569	544	547	1,069
<b>Revenue/Share</b>	25.35	24.99	23.37	28.74	29.53	30.11	31.65	32.25	32.31	28.08
<b>FCF/Share</b>	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.

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