Deutsche Telekom AG (DTEGY)

Updated February 22nd, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$17	**5 Year CAGR Estimate:**	10.0%	**Volatility Percentile:**	13.9%
Fair Value Price:	$18	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	60.2%
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	1.1%	**Growth Percentile:**	22.3%
Dividend Yield:	4.9%	**5 Year Price Target**	$22	**Valuation Percentile:**	66.9%
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**Total Return Percentile:**	61.2%

Overview & Current Events

Deutsche Telekom is the largest telecommunications company in Europe and the second-largest telecommunications company in the world. The company operates through the following segments: Germany, United States, Europe, and System Solutions. The German segment provides fixed-network and mobile solutions as well as wholesale telecommunications services. The United States segment includes T-Mobile (Deutsche Telekom owns ~62% of T-Mobile), while Europe encompasses all fixed-network and mobile operations outside Germany. The Systems Solution segment provides information and communication technology systems. Deutsche Telekom has over 160 million mobile customers, 29 million fixed-network lines, and more than 18 million broadband lines. United States investors can initiate an ownership stake in Deutsche Telekom through American Depository Receipts that trade over-the-counter under the ticker DTEGY with a market capitalization of US$80 billion.

In late February, Deutsche Telekom reported (2/21/19) financial results for the fourth quarter of fiscal 2018. In the year, net revenues increased 0.9% and currency-adjusted net revenues rose 3.1%. The company exhibited strong performance in Germany, where the portion of its customers using product packages combining mobile and fixed network increased from 41.7% in 2017 to 50.7% in 2018. The U.S. segment maintained its strong momentum, as T-Mobile grew the number of its customers almost 10%, from 72.7 to 79.7 million. The company also posted 13.7% growth in its free cash flow and thus it will raise its dividend by 7.7% this year (in €). Moreover, management provided positive guidance for this year. It expects 1%-2% revenue growth, 2%-4% adjusted EBITDA growth and approximate 10% growth in free cash flow.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.64	$0.91	$0.92	$0.66	$0.63	$0.79	$0.77	$0.61	$0.89	$1.13	***$1.20***	***$1.46***
DPS	$1.04	$1.03	$0.99	$0.88	$0.93	$0.68	$0.56	$0.63	$0.65	$0.77	***$0.83***	***$1.05***
Shares	4361.3	4321.3	4321.3	4321.3	4451.5	4476.0	4586.7	4677.0	4761.5	4761.0	***4761.0***	***4750.0***

Deutsche Telekom's earnings growth has been somewhat volatile, partly due to the spinoff of T-Mobile in 2012. Even including the impact of this spinoff, the company grew its earnings-per-share by about 6% per year over the last decade. We believe that this level of growth is likely to continue for the foreseeable future, mostly thanks to continuous growth of T-Mobile. Due to markedly strong performance in 2018, the earnings of that year will raise the bar for future comparisons. Accordingly, we have lowered our expected earnings growth rate beyond this year from 6% to 4%.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	20.0	14.4	14.9	17.2	20.4	20.3	23.1	27.7	20.2	14.6	***14.2***	***15.0***
Avg. Yld.	8.1%	7.9%	7.2%	7.7%	7.2%	4.2%	3.2%	3.7%	3.6%	4.7%	***4.9%***	***4.8%***

Deutsche Telekom's P/E valuation has been volatile over the last decade, ranging from as high as 27.7 to as low as 14, with an average value of 19.3. We believe this historical valuation multiple is far too rich for a company like Deutsche Telekom. Given comparable valuations in the domestic telecommunications industry, our target for Deutsche Telekom's

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fair value is a price-to-earnings ratio of 15. The stock is trading at an earnings multiple of 14.2 today. If it approaches our fair estimate of 15 over the next five years, it will enjoy a 1.1% annualized gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

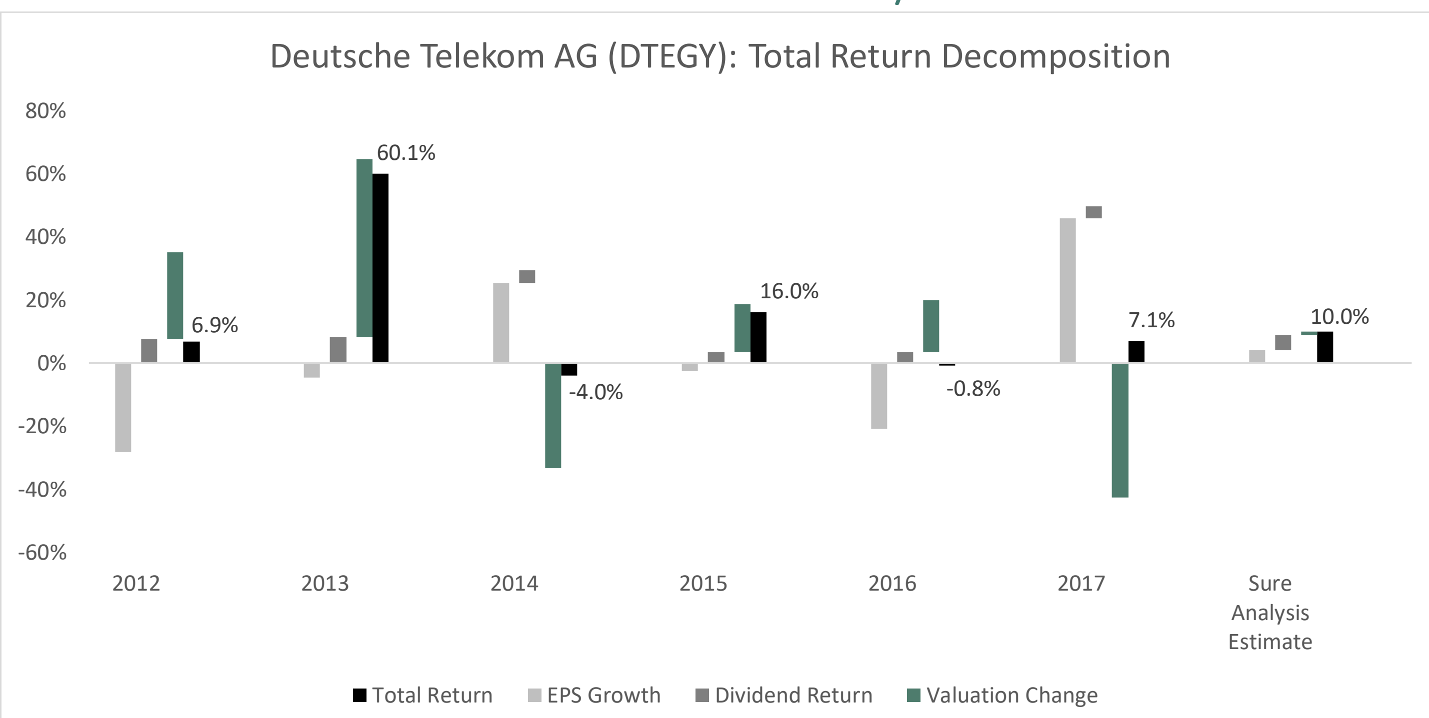
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	163%	113%	108%	133%	148%	86.1%	72.7%	103%	73.0%	68.1%	***69.2%***	***71.9%***

Deutsche Telekom has undisputed leadership within the European telecommunications market and is investing aggressively to maintain this position. Last year, the company invested a record €12.2 billion (US$14.0 billion) to build out its telecommunications network. Deutsche Telekom also has an investment-grade BBB+ credit rating from Standard & Poor's, which allows it to raise capital at attractive rates to continue investing in its future as a business.

Final Thoughts & Recommendation

Deutsche Telekom provides exactly what most investors in the telecommunications sector are looking for: stability, cash flow, and a high dividend payout. Moreover, the company's global business model combined with its ~62% ownership of T-Mobile gives it exposure to telecommunications markets worldwide. In addition, the stock has been trading in a narrow range, between $14 and $20, in the last five years. This means that most returns usually come from its generous dividend. This feature also makes it easier to hold the stock for the long term, without emotional pressure to sell during market sell-offs. At its current price, Deutsche Telekom is likely to offer a 10.0% average annual return over the next five years. As a result, the stock earns a buy recommendation from Sure Dividend at current prices, even though it is still not the most compelling investment opportunity in its sector (AT&T has likely earned this title).

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	90510	90088	82739	81781	74784	79861	83325	76822	80899	84878
Gross Profit	39738	39524	35386	34447	30743	31711	43290	39452	42180	44280
Gross Margin	43.9%	43.9%	42.8%	42.1%	41.1%	39.7%	52.0%	51.4%	52.1%	52.2%
SG&A Exp.	30490	28610	26285	26817	24266	24219	209	280	239	318
D&A Exp.	16109	19375	15652	20128	28229	14481	14062	12606	14809	16519
Operating Profit	10333	8384	8714	12559	7200	7573	6750	7020	6703	7761
Op. Margin	11.4%	9.3%	10.5%	15.4%	9.6%	9.5%	8.1%	9.1%	8.3%	9.1%
Net Profit	2177	492	2247	750	-6882	1235	3888	3611	2961	3920
Net Margin	2.4%	0.5%	2.7%	0.9%	-9.2%	1.5%	4.7%	4.7%	3.7%	4.6%
Free Cash Flow	9777	9194	6468	10887	6615	2588	2060	426	2095	-2601

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets ($B)	172.08	182.72	169.98	158.67	142.75	163.15	157.30	157.35	156.97	169.56
Cash & Equivalents	4229	7181	3735	4856	5324	11006	9148	7540	8190	3973
Acc. Receivable	10331	9663	9162	8493	10625	13708	15679	12518	15099	15078
Inventories	1808	1679	1742	1404	1463	1466	1828	2019	1722	2381
Goodwill & Int.	75358	73938	71561	65059	55343	63474	62704	62345	64063	75419
Total Liab. ($B)	111.83	122.75	112.76	106.82	102.38	118.87	115.88	115.64	115.91	118.61
Accounts Payable	9884	9015	8977	8337	8484	9985	11711	12067	10982	13118
Long-Term Debt	65110	0	67224	62586	55433	67069	64049	63080	61847	64721
Total Equity	55892	51986	50560	45856	34290	32974	30932	32143	30980	36872
D/E Ratio	1.16	0.00	1.33	1.36	1.62	2.03	2.07	1.96	2.00	1.76

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	1.2%	0.3%	1.3%	0.5%	-4.6%	0.8%	2.4%	2.3%	1.9%	2.4%
Return on Equity	3.7%	0.9%	4.4%	1.6%	-17.2%	3.7%	12.2%	11.4%	9.4%	11.6%
ROIC	1.7%	0.5%	2.4%	0.6%	-6.5%	1.2%	3.6%	3.4%	2.9%	3.6%
Revenue/Share	20.80	20.76	19.09	19.02	17.39	18.27	18.62	16.87	17.49	18.05
FCF/Share	2.25	2.12	1.49	2.53	1.54	0.59	0.46	0.09	0.45	-0.55

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