



# Telephone & Data Systems (TDS)

Updated February 27<sup>th</sup>, 2019 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$32	<b>5 Year CAGR Estimate:</b>	6.3%	<b>Volatility Percentile:</b>	72.2%
<b>Fair Value Price:</b>	\$36	<b>5 Year Growth Estimate:</b>	2.0%	<b>Momentum Percentile:</b>	70.8%
<b>% Fair Value:</b>	89%	<b>5 Year Valuation Multiple Estimate:</b>	2.2%	<b>Growth Percentile:</b>	5.1%
<b>Dividend Yield:</b>	2.1%	<b>5 Year Price Target</b>	\$40	<b>Valuation Percentile:</b>	73.4%
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	D	<b>Total Return Percentile:</b>	29.3%

## 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 (~78%). TDS started in 1969 as a collection of 10 rural telephone companies. Today the company has a market cap of \$3.6 billion and more than \$5 billion in annual revenues.

In late February, TDS reported (2/22/19) financial results for the fourth quarter of fiscal 2018. In the year, the company grew its revenue by 1% thanks to the 2% revenue growth of U.S. Cellular, which grew its customer base and exhibited increased inbound roaming. Thanks to this segment, TDS more than doubled its adjusted earnings-per-share, from \$0.53 in 2017 to \$1.17 in 2018. However, the company missed analyst estimates on for both revenues and profits in the fourth quarter. Consequently, the stock plunged 11% on the day of its earnings release. Management provided guidance for 2.3% to 7.2% revenue growth but essentially flat adjusted EBITDA in 2019.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$1.63	\$1.25	\$1.68	\$0.75	\$1.29	\$1.26	\$1.98	\$0.39	\$0.53	\$1.17	<b>\$1.35</b>	<b>\$1.60</b>
<b>BPS<sup>1</sup></b>	\$32.81	\$33.75	\$33.60	\$37.16	\$37.85	\$36.39	\$37.86	\$37.67	\$43.68	\$46.02	<b>\$47.00</b>	<b>\$52.00</b>
<b>DPS</b>	\$0.40	\$0.41	\$0.43	\$0.49	\$0.51	\$0.54	\$0.56	\$0.59	\$0.62	\$0.64	<b>\$0.66</b>	<b>\$0.80</b>
<b>Shares</b>	115.1	113.0	117.9	107.9	108.8	107.9	109.0	110.0	112.0	115.0	<b>117.0</b>	<b>125.0</b>

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.

The company has exhibited a markedly volatile performance record. During the last decade, its earnings-per-share have declined approximately 3.6% per year on average. On the other hand, thanks to the strong momentum of U.S. Cellular, we expect TDS to earn about \$1.35 per share this year.

While the earnings trend has been volatile, book value per share has grown by 4.1% 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 \$52 by 2024 for a 2.0% average annual growth of book value over the next five years.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
<b>Avg. P/B</b>	0.91	0.99	0.87	0.64	0.67	0.70	0.72	0.73	0.73	0.63	<b>0.68</b>	<b>0.76</b>
<b>Avg. Yld.</b>	1.4%	1.4%	1.6%	2.1%	2.0%	2.1%	2.1%	2.1%	2.2%	2.2%	<b>2.1%</b>	<b>2.0%</b>

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. TDS is currently trading at a price-to-book ratio of 0.68, which is lower than its 10-year average of 0.76. If the stock reverts to its average valuation level over the next five years, it will enjoy a 2.2% annualized gain.

<sup>1</sup> Book-value-per-share

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

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	24.5%	32.8%	25.6%	65.3%	39.5%	42.9%	28.3%	151%	117%	54.7%	48.9%	50.0%

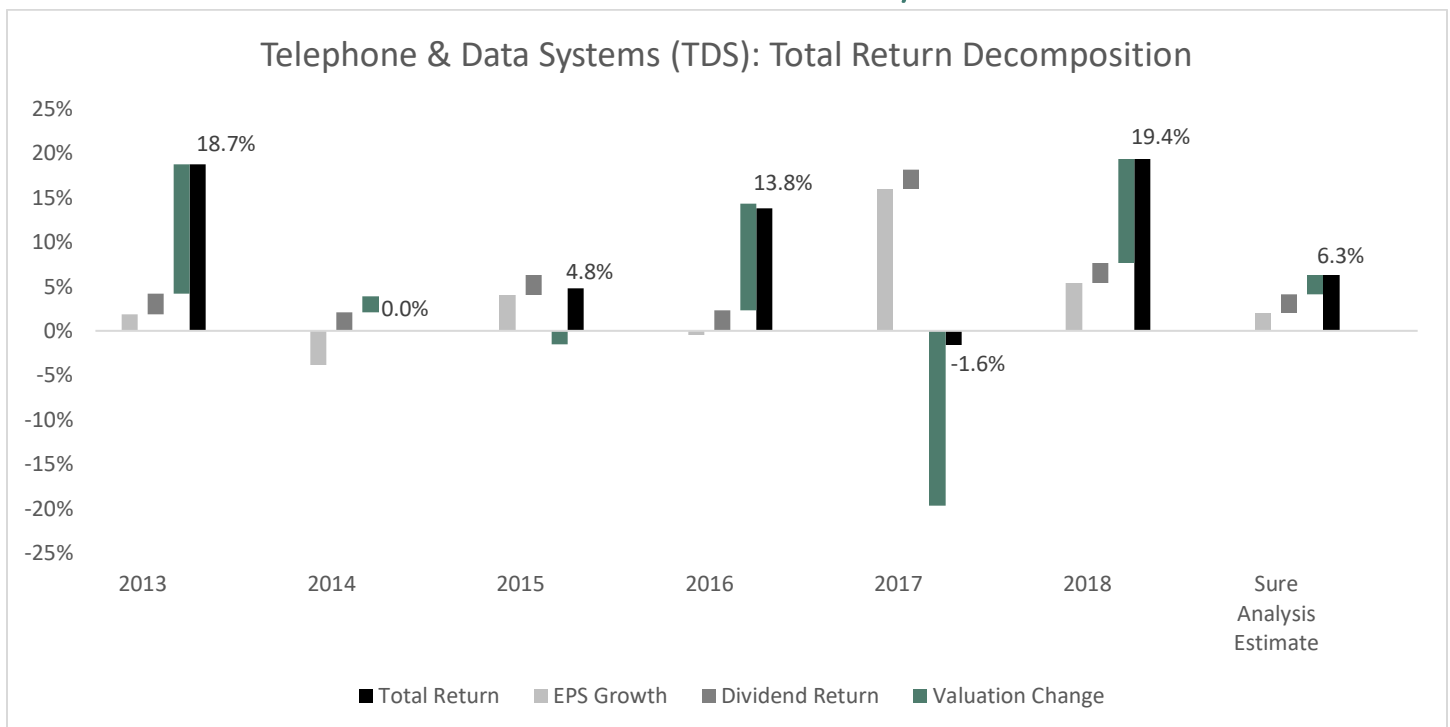
TDS has raised its dividend for 45 consecutive years. It has grown its dividend by 5.1% per year on average over the past 10 years. However, its current 2.1% dividend yield is only slightly above the yield of the S&P. Moreover, the company has exhibited serious volatility in its results. This is a negative that 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. As TDS operates in a highly competitive business, it lacks a meaningful competitive advantage.

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 more than doubled its earnings last year thanks to the solid performance of U.S. Cellular. However, due to its slow growth, the stock is likely to offer just a 6.3% 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 sell 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Revenue</b>	5020	4987	5180	5345	4901	5009	5210	5155	5044	5109
<b>Gross Profit</b>	3149	3062	3130	3073	2676	2498	2795	2726	2685	2773
<b>Gross Margin</b>	62.7%	61.4%	60.4%	57.5%	54.6%	49.9%	53.6%	52.9%	53.2%	54.3%
<b>SG&amp;A Exp.</b>	1964	1998	2002	2034	1948	1865	1781	1762	1689	1694
<b>D&amp;A Exp.</b>		756	766	814	1018	837	844	850	844	883
<b>Operating Profit</b>	436	308	362	225	-290	-204	170	114	152	196
<b>Operating Margin</b>	8.7%	6.2%	7.0%	4.2%	-5.9%	-4.1%	3.3%	2.2%	3.0%	3.8%
<b>Net Profit</b>	189	145	201	82	142	-136	219	43	153	135
<b>Net Margin</b>	3.8%	2.9%	3.9%	1.5%	2.9%	-2.7%	4.2%	0.8%	3.0%	2.6%
<b>Free Cash Flow</b>	431	337	284	110	-389	-404	-11	146	91	241
<b>Income Tax</b>	134	95	114	74	126	-5	172	40	-279	46

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	7612	7763	8201	8624	8904	8854	9422	9446	9295	9783
<b>Cash &amp; Equivalents</b>	671	368	563	740	830	472	985	900	619	921
<b>Accounts Receivable</b>	515	513	394	410	552	549	705	753	861	992
<b>Inventories</b>	157	116	130	161	245	274	158	151	145	150
<b>Goodwill &amp; Int. Ass.</b>	2177	2219	2342	2336	2456	2534	2901	2938	3020	2957
<b>Total Liabilities</b>	3184	3301	3598	3968	4234	4399	4718	4696	4403	4490
<b>Accounts Payable</b>	347	344	365	377	496	387	349	365	368	365
<b>Long-Term Debt</b>	1495	1502	1531	1723	1722	1942	2454	2445	2457	2439
<b>Shareholder's Equity</b>	3764	3814	3962	4012	4118	3926	4126	4144	4269	4560
<b>D/E Ratio</b>	0.40	0.39	0.39	0.43	0.42	0.49	0.59	0.59	0.58	0.53

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Return on Assets</b>	2.5%	1.9%	2.5%	1.0%	1.6%	-1.5%	2.4%	0.5%	1.6%	1.4%
<b>Return on Equity</b>	5.0%	3.8%	5.2%	2.1%	3.5%	-3.4%	5.4%	1.0%	3.6%	3.1%
<b>ROIC</b>	3.2%	2.4%	3.3%	1.3%	2.2%	-2.1%	3.2%	0.6%	2.1%	1.8%
<b>Shares Out.</b>	115.1	113.0	117.9	107.9	108.8	107.9	109.0	110.0	112.0	115.0
<b>Revenue/Share</b>	42.15	45.13	47.48	49.07	44.91	46.38	47.36	46.44	45.04	44.82
<b>FCF/Share</b>	3.62	3.05	2.60	1.01	-3.57	-3.74	-0.10	1.32	0.81	2.11

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

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