



CenturyLink (CTL)

Updated November 27th, 2019 by Quinn Mohammed

Key Metrics

Current Price:	\$14	5 Year CAGR Estimate:	12.5%	Volatility Percentile:	88.1%
Fair Value Price:	\$14	5 Year Growth Estimate:	5.0%	Momentum Percentile:	10.6%
% Fair Value:	98%	5 Year Valuation Multiple Estimate:	0.4%	Growth Percentile:	40.1%
Dividend Yield:	7.1%	5 Year Price Target	\$18	Valuation Percentile:	64.5%
Dividend Risk Score:	F	Retirement Suitability Score:	C	Total Return Percentile:	76.5%

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 \$16 billion market capitalization and should produce over \$20 billion in revenue this year.

CenturyLink reported third quarter earnings on November 6th and posted total revenue of \$5.61 billion, compared to \$5.82 billion for the third quarter 2018. Adjusted earnings per share were \$0.31 compared to \$0.30 last year, a 3.3% increase.

On a yearly basis, total broadband subscribers fell from 4,843 to 4,714, for a decrease of 2.7%. Despite this, broadband revenue was the only consumer metric which increased YoY, by 2.3%. All other consumer metrics (voice, regulatory, retail video, professional services) revenue was down double-digits year-over-year. This is due to the loss of subscribers in broadband being at the lower tier of offerings, while the higher tiers are increasing.

CenturyLink has made some progress in reducing its leverage to their new target range of 2.75X – 3.25X adjusted EBITDA, and as of this quarter stand at 3.7 times EBITDA vs 4.1 times in third quarter 2018. The company expects to reach their new target range in approximately 3 years. The company has been successful in increasing their adjusted EBITDA margin, seeing it go from 39.3% last year to 40.3% today for a 100 basis points increase.

Management reiterated their full year guidance and expects \$9 to \$9.2 billion in adjusted EBITDA for fiscal year 2019. They also expect free cash flow of \$3.1 to \$3.4 billion and a full year effective income tax rate of around 25%.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$3.46	\$3.41	\$1.07	\$1.25	\$1.64	\$2.61	\$2.72	\$2.45	\$1.58	\$1.42	\$1.30	\$1.66
DPS	\$2.80	\$2.90	\$2.90	\$2.90	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$1.00	\$1.00
Shares¹	299	305	619	626	584	569	544	547	1,069	1,067	1,075	1,100

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 achieved \$850 million in cost saving synergies from the merger in 2018 and continued this trend in 2019 with further savings of \$360 million to-date. Reduced leverage should help improve margins over time as well as less of the company's earnings will be consumed by interest expense.

Following the dividend cut in early 2019, we do not believe management will raise the payout anytime soon given the aggressive leverage target of around 3.0 times EBITDA.

¹ In millions

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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	10.8	11.0
Avg. Yld.	9.1%	7.8%	7.5%	7.4%	6.2%	5.9%	6.9%	7.7%	9.8%	11.4%	7.1%	5.5%

CenturyLink's volatile price-to-earnings ratio stands at 10.8 now after a year-over-year earnings decline. We are reiterating our fair value estimate of 11 times earnings given the marked weakness in the company's recent results, representing a 0.4% annual growth due to valuation multiple expansion. 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, at 5.5%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	54%	85%	271%	232%	132%	83%	79%	88%	129%	152%	77%	60%

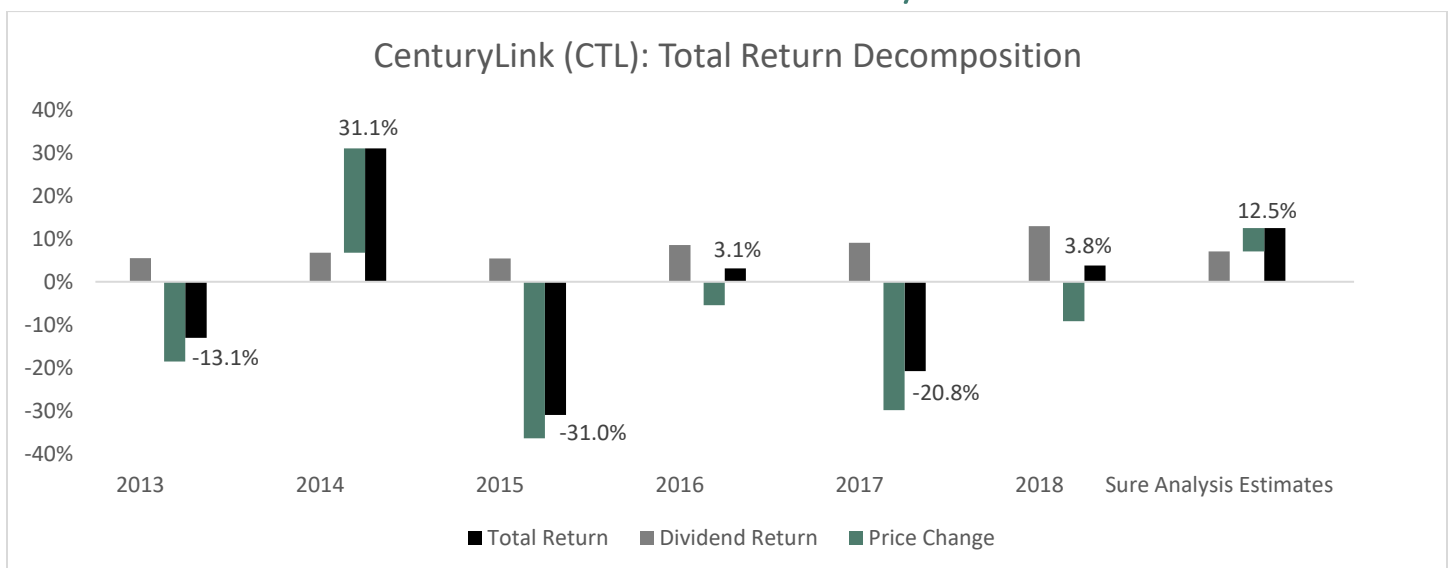
CenturyLink's payout ratio is now back under 100% after the dividend cut, and we expect the dividend will remain at \$1 per share for the foreseeable future. Management has made it clear the priority is reducing leverage, so we see the payout ratio drifting lower over time as earnings grow but the dividend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

CenturyLink's competitive advantage is in its diversified model as well as its tremendous size and geographic reach. It can 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 offers decent growth potential and an enormous yield. We see total returns of 12.5% going forward, consisting of the 7.1% current yield, 5% earnings growth and a 0.4% tailwind from the valuation. This remains a high-risk, high-reward situation, particularly considering the recent dividend cut and declining revenue. Thus, despite the high projected total returns, we reiterate CenturyLink at a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	4974	7042	15351	18376	18095	18031	17900	17470	17656	23443
Gross Profit	3222	4498	9026	10737	10588	10185	10122	9696	9453	12581
Gross Margin	64.8%	63.9%	58.8%	58.4%	58.5%	56.5%	56.5%	55.5%	53.5%	53.7%
SG&A Exp.	1014	1004	2975	3244	3502	3347	3354	3447	3508	4165
D&A Exp.	975	1434	4026	4780	4541	4428	4189	3916	3936	5120
Operating Profit	1233	2060	2025	2713	2545	2410	2579	2333	2009	3296
Operating Margin	24.8%	29.3%	13.2%	14.8%	14.1%	13.4%	14.4%	13.4%	11.4%	14.1%
Net Profit	647	948	573	777	-239	772	878	626	1389	-1733
Net Margin	13.0%	13.5%	3.7%	4.2%	-1.3%	4.3%	4.9%	3.6%	7.9%	-7.4%
Free Cash Flow	817	1181	1790	3146	2511	2141	2281	1627	772	3857
Income Tax	302	583	375	473	463	338	438	394	-849	170

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	22563	22038	56044	53940	51787	49103	47604	47017	75611	70256
Cash & Equivalents	162	173	128	211	168	128	126	222	551	488
Accounts Receivable	686	713	1768	1782	1862	1821	1789	1882	2245	2094
Inventories	36	33	107	125	167	132	144	134	128	120
Goodwill & Int. Ass.	12342	12140	32214	30597	28411	27295	26225	23978	43248	38810
Total Liabilities	13096	12391	35217	34651	34596	34080	33544	33618	52120	50428
Accounts Payable	395	300	1400	1207	1111	1226	968	1179	1555	1933
Long-Term Debt	7754	7328	21836	20605	20966	20503	20225	19688	37726	36061
Shareholder's Equity	9461	9641	20827	19289	17191	15023	14060	13399	23491	19828
D/E Ratio	0.82	0.76	1.05	1.07	1.22	1.36	1.44	1.47	1.61	1.82

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	4.2%	4.3%	1.5%	1.4%	-0.5%	1.5%	1.8%	1.3%	2.3%	-2.4%
Return on Equity	10.3%	9.9%	3.8%	3.9%	-1.3%	4.8%	6.0%	4.6%	7.5%	-8.0%
ROIC	5.5%	5.5%	1.9%	1.9%	-0.6%	2.1%	2.5%	1.9%	2.9%	-3.0%
Shares Out.	299	305	619	626	584	569	544	547	1,069	1,067
Revenue/Share	24.99	23.37	28.74	29.53	30.11	31.65	32.25	32.31	28.08	21.99
FCF/Share	4.11	3.92	3.35	5.06	4.18	3.76	4.11	3.01	1.23	3.62

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