Deutsche Telekom AG (DTEGY)

Updated November 10th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$17	**5 Year CAGR Estimate:**	8.7%	**Volatility Percentile:**	14.1%
Fair Value Price:	$18	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	31.6%
% Fair Value:	94%	**5 Year Valuation Multiple Estimate:**	1.1%	**Growth Percentile:**	27.9%
Dividend Yield:	4.6%	**5 Year Price Target**	$22	**Valuation Percentile:**	79.2%
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Total Return Percentile:**	78.4%

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 almost 180 million mobile customers, 28 million fixed-network lines, and more than 20 million broadband lines. United States investors can initiate an ownership stake in Deutsche Telekom through American Depository Receipts that trade under the ticker DTEGY with a market capitalization of US$81 billion.

The $26 billion merger between Sprint and T-Mobile has stalled, but Deutsche Telekom expects the deal to close in early 2020. The combined entity will enjoy increased network coverage and will have about 125 million customers, much closer to the 150 and 141 million customers of Verizon and AT&T, respectively, than before the merger.

In early November, Deutsche Telekom reported (11/7/19) financial results for the third quarter of fiscal 2019. Net revenue increased 6.8% and currency-adjusted comparable net revenue rose 2.7%. The U.S. segment was the major growth driver, as it maintained its strong momentum, with 11.8% net revenue growth and 5.2% currency-adjusted net revenue growth. The strong performance resulted primarily from higher service revenues thanks to the rise in the average branded customer base and low customer churn rate. Revenue in the German segment rose 0.8% while revenue in Europe grew 2.2%. Adjusted earnings-per-share increased 7% over last year's quarter, from €0.28 to €0.30.

Despite positive outlook, management announced that it will cut the annual dividend from €0.70 to €0.60 next year due to the high cost borne in the German 5G spectrum auction. That level will represent the new minimum for the dividend.

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	***$0.78***	***$0.78***
Shares[1]	4,361	4,321	4,321	4,321	4,452	4,476	4,587	4,677	4,762	4,761	***4,740***	***4,740***

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 could continue for the foreseeable future, mostly thanks to continuous growth of T-Mobile. However, due to markedly strong performance in 2018, the earnings of that year will raise the bar for future comparisons. Accordingly, we expect a 4% annual earnings-per-share growth rate beyond this year.

[1] In millions.

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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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%	***4.6%***	***3.6%***

Deutsche Telekom's price-to-earnings ratio has been volatile over the last decade, ranging from as high as 27.7 to as low as 13, 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 fair value is a price-to-earnings ratio of 15. The stock is trading at an almost decade-low 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

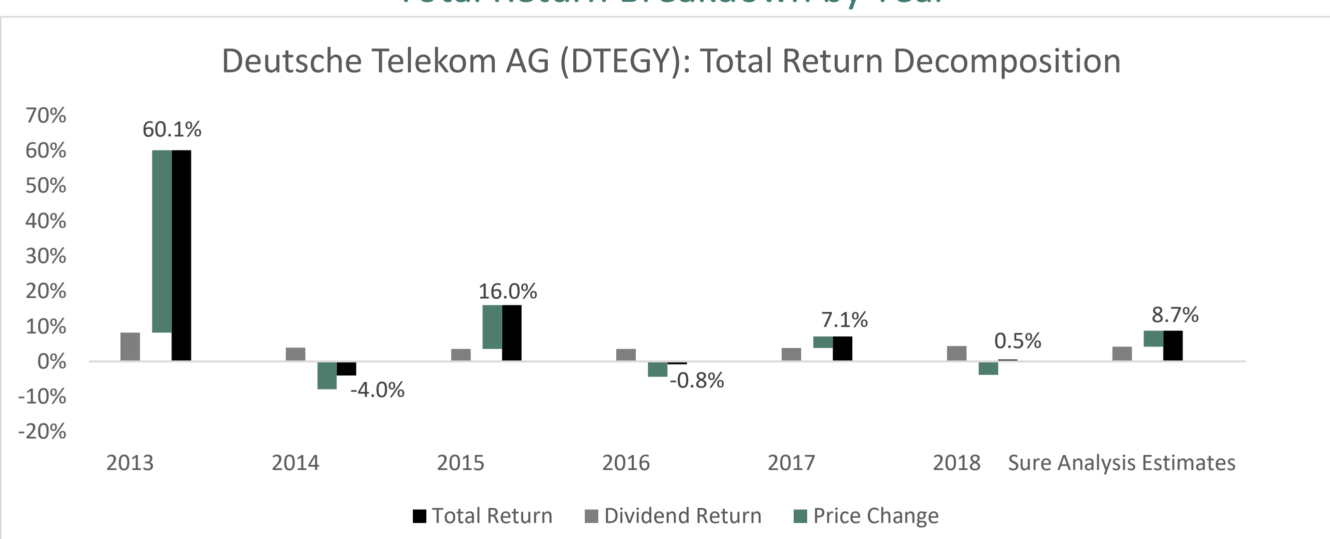
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	163%	113%	108%	133%	148%	86.1%	72.7%	103%	73.0%	68.1%	***65.0%***	***53.4%***

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, most of the time in the last five years. Most returns thus 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. Near its current 10-year low valuation level, Deutsche Telekom could offer an 8.7% average annual return over the next five years. While this is normally insufficient to render a stock a "buy," we maintain our buy rating for this stock thanks to its stability, its promising prospects from the pending merger and its cheap valuation.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	90088	82739	81781	74784	79861	83325	76822	80899	84878	88975
Gross Profit	39524	35386	34447	30743	31711	43290	39452	42180	44280	46772
Gross Margin	43.9%	42.8%	42.1%	41.1%	39.7%	52.0%	51.4%	52.1%	52.2%	52.6%
SG&A Exp.	28610	26340	26883	24337	24324	314	353	336	399	509
D&A Exp.	19375	15652	20128	28229	14481	14062	12606	14809	16519	16338
Operating Profit	8384	8658	12493	7129	7538	6045	6591	7225	8204	9059
Op. Margin	9.3%	10.5%	15.3%	9.5%	9.4%	7.3%	8.6%	8.9%	9.7%	10.2%
Net Profit	492	2247	750	-6882	1235	3888	3611	2961	3920	2558
Net Margin	0.5%	2.7%	0.9%	-9.2%	1.5%	4.7%	4.7%	3.7%	4.6%	2.9%
Free Cash Flow	9194	6468	10887	6615	2588	2060	426	2095	-2603	6443

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets ($B)	183	170	159	143	163	157	157	157	170	166
Cash & Equivalents	7181	3735	4856	5324	11006	9148	7540	8190	3973	4208
Acc. Receivable	9663	9162	8493	8353	10467	12479	9573	9704	11461	11425
Inventories	1679	1742	1404	1463	1466	1828	2019	1722	2381	2048
Goodwill & Int.	73938	71561	65059	55343	63474	62704	62345	64063	75419	74296
Total Liab. ($B)	123	113	107	102	119	116	116	116	119	117
Accounts Payable	9015	8977	8337	8484	9985	11711	12067	10982	13118	12239
Long-Term Debt	0	67224	62586	55433	67069	64049	63080	61847	64721	67178
Total Equity	51986	50560	45856	34290	32974	30932	32143	30980	36872	35355
D/E Ratio	0.00	1.33	1.36	1.62	2.03	2.07	1.96	2.00	1.76	1.90

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	0.3%	1.3%	0.5%	-4.6%	0.8%	2.4%	2.3%	1.9%	2.4%	1.5%
Return on Equity	0.9%	4.4%	1.6%	-17.2%	3.7%	12.2%	11.4%	9.4%	11.6%	7.1%
ROIC	0.5%	2.4%	0.6%	-6.5%	1.2%	3.6%	3.4%	2.9%	3.6%	2.2%
Shares Out.	4,361	4,321	4,321	4,321	4,452	4,476	4,587	4,677	4,762	4,761
Revenue/Share	20.76	19.09	19.02	17.39	18.27	18.62	16.87	17.49	18.05	18.76
FCF/Share	2.12	1.49	2.53	1.54	0.59	0.46	0.09	0.45	-0.55	1.36

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