



Telephone & Data Systems (TDS)

Updated November 15th, 2019 by Quinn Mohammed

Key Metrics

Current Price:	\$23	5 Year CAGR Estimate:	9.4%	Volatility Percentile:	80.4%
Fair Value Price:	\$29	5 Year Growth Estimate:	1.5%	Momentum Percentile:	5.8%
% Fair Value:	78%	5 Year Valuation Multiple Estimate:	5.1%	Growth Percentile:	7.5%
Dividend Yield:	2.8%	5 Year Price Target	\$32	Valuation Percentile:	93.0%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	64.6%

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 across 24 U.S. states. The company's Cellular Division accounts for more than 75% of total operating revenue. TDS started in 1969 as a collection of 10 rural telephone companies. Today the company has a market cap of \$2.5 billion and more than \$5 billion in annual revenues.

On October 31st, TDS reported financial results for the third quarter of fiscal 2019. In the quarter, the company grew its total operating revenue by 1.9% year-over-year to \$1.32 billion.

On August 25th, TDS reported financial results for the second quarter of fiscal 2019. In the quarter, the company grew its total operating revenue by 0.5%, year-over-year to \$1.26 billion. This growth is comprised of 3% revenue growth in U.S. Cellular and a 1% decline at TDS Telecom. Diluted earnings per share fell 63% year-over-year to \$0.15 a share. The company has 116 million shares outstanding, whereas last year there were a total 114 million shares outstanding.

Management slightly narrowed guidance for U.S. Cellular by increasing the low band and reducing the top band by \$50 million in revenue. This time, the updated revenue estimate for U.S. Cellular is \$3.95 to \$4.05 billion. Estimates for the TDS Telecom division remain unchanged. Total estimated revenue for 2019 is now \$5.15 billion at the mid-point of guidance. Adjusted EBITDA remains relatively in line with prior estimates but narrowed slightly to \$1.28 billion at the mid-point of guidance. Capex is estimated to be roughly \$1 billion for the full year 2019.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.67	\$1.31	\$1.83	\$0.75	\$1.29	-\$1.26	\$1.98	\$0.39	\$1.37	\$1.17	\$1.10	\$1.20
BPS¹	\$32.8	\$33.75	\$33.60	\$37.16	\$37.85	\$36.39	\$37.86	\$37.67	\$38.45	\$40.00	\$40.50	\$43.63
DPS	\$0.40	\$0.41	\$0.43	\$0.49	\$0.51	\$0.54	\$0.56	\$0.59	\$0.62	\$0.64	\$0.66	\$0.80
Shares²	115	113	118	108	109	108	109	110	112.0	115	116	125

TDS has an 82% 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 3.5% compounded per year on average. On the other hand, thanks to the momentum of U.S. Cellular, we expect TDS to earn about \$1.10 per share this year.

While the earnings trend has been volatile, book value per share has grown by 2.0% 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 \$43.63 by 2024 for a 1.5% average annual growth of book value over the next five years.

¹ Book-value-per-share

² In millions

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/B	0.91	0.99	0.87	0.64	0.67	0.70	0.72	0.73	0.73	0.63	0.57	0.73
Avg. Yld.	1.4%	1.4%	1.6%	2.1%	2.0%	2.1%	2.1%	2.1%	2.2%	2.2%	2.8%	2.5%

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 0.57, which is lower than its 10-year average of 0.76 and median of 0.73. If the stock reverts to its average valuation level over the next five years, it will enjoy a 5.1% annualized gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	24%	31%	23%	65%	40%	---	28%	151%	45%	55%	60%	67%

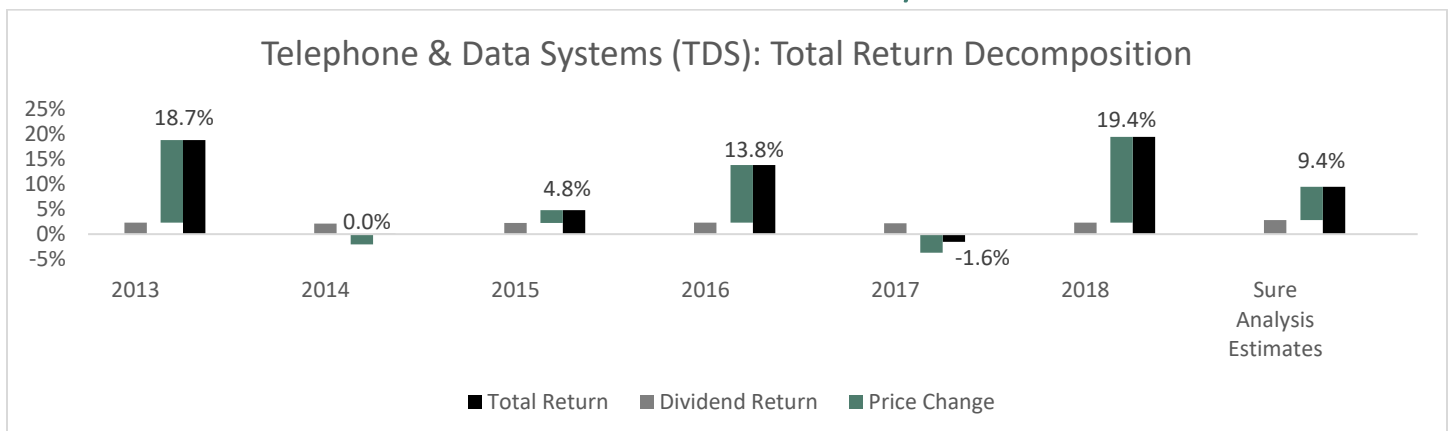
TDS has raised its dividend for 45 consecutive years. It has grown its dividend by 3.5% per year on average over the past 5 years. Today, its 2.8% dividend yield is 100 basis points above the yield of the S&P. Moreover, the company has exhibited serious volatility in its results. This is a negative that 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 relies heavily on the performance of U.S. Cellular, however management continues to lower revenue guidance for the full year, which negatively affects the share price. We forecast the stock will offer a 9.4% average annual return over the next five years. We have been somewhat conservative in our forecast due to the extremely volatile performance record, which makes for a risky holding. Growth is expected to be slow and the bulk of the return would be due to valuation expansion. Our forecasted 9.4% annual return is composed of a 5.1% gain from the multiple valuation expansion, 2.8% from the yield, and 1.5% from book value growth. We rate TDS a hold and think there are better opportunities in the telecom space, namely AT&T (T).

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	5020	4987	5180	5345	4901	5009	5210	5155	5044	5109
Gross Profit	3149	3062	3130	3073	2676	2498	2795	2726	2685	2773
Gross Margin	62.7%	61.4%	60.4%	57.5%	54.6%	49.9%	53.6%	52.9%	53.2%	54.3%
SG&A Exp.	1964	1998	2002	2034	1948	1865	1781	1762	1689	1694
D&A Exp.		756	766	814	1018	837	844	850	844	883
Operating Profit	436	308	362	225	-290	-204	170	114	152	196
Operating Margin	8.7%	6.2%	7.0%	4.2%	-5.9%	-4.1%	3.3%	2.2%	3.0%	3.8%
Net Profit	189	145	201	82	142	-136	219	43	153	135
Net Margin	3.8%	2.9%	3.9%	1.5%	2.9%	-2.7%	4.2%	0.8%	3.0%	2.6%
Free Cash Flow	431	337	284	110	-389	-404	-11	146	91	241
Income Tax	134	95	114	74	126	-5	172	40	-279	46

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	7612	7763	8201	8624	8904	8854	9422	9446	9295	9783
Cash & Equivalents	671	368	563	740	830	472	985	900	619	921
Accounts Receivable	515	513	394	410	552	549	705	753	861	992
Inventories	157	116	130	161	245	274	158	151	145	150
Goodwill & Int. Ass.	2177	2219	2342	2336	2456	2534	2901	2938	3020	2957
Total Liabilities	3184	3301	3598	3968	4234	4399	4718	4696	4403	4490
Accounts Payable	347	344	365	377	496	387	349	365	368	365
Long-Term Debt	1495	1502	1531	1723	1722	1942	2454	2445	2457	2439
Shareholder's Equity	3764	3814	3962	4012	4118	3926	4126	4144	4269	4560
D/E Ratio	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
Return on Assets	2.5%	1.9%	2.5%	1.0%	1.6%	-1.5%	2.4%	0.5%	1.6%	1.4%
Return on Equity	5.0%	3.8%	5.2%	2.1%	3.5%	-3.4%	5.4%	1.0%	3.6%	3.1%
ROIC	3.2%	2.4%	3.3%	1.3%	2.2%	-2.1%	3.2%	0.6%	2.1%	1.8%
Shares Out.	115.1	113.0	117.9	107.9	108.8	107.9	109.0	110.0	112.0	115.0
Revenue/Share	42.15	45.13	47.48	49.07	44.91	46.38	47.36	46.44	45.04	44.82
FCF/Share	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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