



# CenturyLink (CTL)

Updated February 25<sup>th</sup>, 2019 by Quinn Mohammed

## Key Metrics

<b>Current Price:</b>	\$12.50	<b>5 Year CAGR Estimate:</b>	13.2%	<b>Market Cap:</b>	\$13.6B
<b>Fair Value Price:</b>	\$15.70	<b>5 Year Growth Estimate:</b>	3.0%	<b>Ex-Dividend Date:</b>	03/11/2020
<b>% Fair Value:</b>	79%	<b>5 Year Valuation Multiple Estimate:</b>	4.7%	<b>Payment Date:</b>	03/22/2020
<b>Dividend Yield:</b>	7.7%	<b>5 Year Price Target</b>	\$18	<b>Last Dividend Increase:</b>	0
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	B	<b>Years of Dividend Growth:</b>	0

## 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 \$13.6 billion market capitalization and produced \$22 billion in revenue in 2019.

CenturyLink reported fourth quarter and full year 2019 earnings on February 12<sup>th</sup>. Total revenue for the quarter was down 3.6% from last year to \$5.57 billion. Adjusted earnings per share were \$0.33 compared to \$0.37 last year, a 10.8% decrease. For the full fiscal year 2019, total revenues decreased 4.4% to \$22.4 billion. Adjusted earnings per share were \$1.32, up from \$1.19 a year ago. The company reduced net debt by roughly \$2 billion and has a total net debt remaining of \$33.35 billion.

On a yearly basis, total broadband subscribers fell from 4,812 to 4,678, for a decrease of 2.8%. Despite this, broadband revenue was the only consumer metric which increased YoY, by 2.1%. This is due to the loss of subscribers in broadband being at the lower tier of offerings, while the higher tiers are increasing. All other consumer metrics (voice, regulatory, retail video, professional services) revenue was down double-digits year-over-year.

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 4.0 times in fourth 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 38.6% last year to 40.5% today for a 190 basis points increase. Dividends paid were dropped in half due to the dividend reduction and interest expense dropped 7% YoY due to debt reduction.

Management has posted full year guidance and expects \$9 to \$9.2 billion in adjusted EBITDA for fiscal year 2020. They also expect free cash flow of \$3.1 to \$3.4 billion and a full year effective income tax rate of around 28%.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$3.41	\$1.07	\$1.25	\$1.64	\$2.61	\$2.72	\$2.45	\$1.58	\$1.19	<b>\$1.32</b>	<b>\$1.43</b>	<b>\$1.66</b>
<b>DPS</b>	\$2.90	\$2.90	\$2.90	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	<b>\$1.00</b>	<b>\$1.00</b>	<b>\$1.00</b>
<b>Shares<sup>1</sup></b>	305	619	626	584	569	544	547	1,069	1,067	<b>1,078</b>	<b>1,080</b>	<b>1,100</b>

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 3% 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 is also investing to expand network footprint and enhance the product portfolio. The company achieved \$850 million in cost saving synergies from the merger in 2018 and continued this trend in 2019 with further savings of \$430 million. Reduced leverage should help improve margins over time as well as less of the company's earnings will be consumed by interest expense.

<sup>1</sup> In millions

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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.

## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	10.9	36.2	31.4	21.3	14.0	11.6	11.4	13.9	13.3	<b>10.8</b>	<b>8.7</b>	<b>11.0</b>
Avg. Yld.	7.8%	7.5%	7.4%	6.2%	5.9%	6.9%	7.7%	9.8%	11.4%	<b>13.0%</b>	<b>8.0%</b>	<b>5.5%</b>

CenturyLink's volatile price-to-earnings ratio stands at 8.7 now as earnings remain below record levels. We are reiterating our fair value estimate of 11 times earnings given the marked weakness in the company's recent results, representing a 4.7% 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	85%	271%	232%	132%	83%	79%	88%	137%	182%	76%	<b>70%</b>	<b>60%</b>

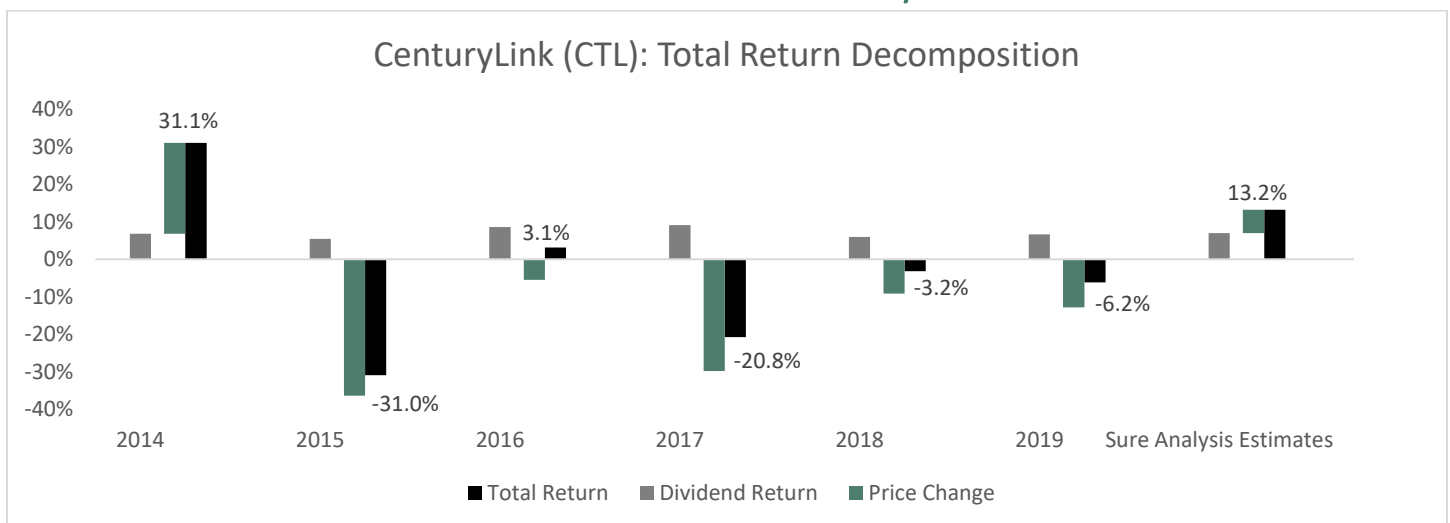
CenturyLink's payout ratio is now back under 100% after the dividend cut, and we expect the dividend will remain at \$1 per share for the foreseeable future. Management has made it clear the priority is reducing leverage, so we see the payout ratio drifting lower over time as earnings grow but the dividend 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 13.2% going forward, half of which comes from the dividend that was just cut. 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Revenue</b>	7042	15351	18376	18095	18031	17900	17470	17656	23443	22401
<b>Gross Profit</b>	4498	9026	10737	10588	10185	10122	9696	9453	12581	12324
<b>Gross Margin</b>	63.9%	58.8%	58.4%	58.5%	56.5%	56.5%	55.5%	53.5%	53.7%	55.0%
<b>SG&amp;A Exp.</b>	1004	2975	3244	3502	3347	3354	3447	3508	4165	3715
<b>D&amp;A Exp.</b>	1434	4026	4780	4541	4428	4189	3916	3936	5120	4829
<b>Operating Profit</b>	2060	2025	2713	2545	2410	2579	2333	2009	3296	3780
<b>Operating Margin</b>	29.3%	13.2%	14.8%	14.1%	13.4%	14.4%	13.4%	11.4%	14.1%	16.9%
<b>Net Profit</b>	948	573	777	-239	772	878	626	1389	-1733	-5269
<b>Net Margin</b>	13.5%	3.7%	4.2%	-1.3%	4.3%	4.9%	3.6%	7.9%	-7.4%	-23.5%
<b>Free Cash Flow</b>	1181	1790	3146	2511	2141	2281	1627	772	3857	3052
<b>Income Tax</b>	583	375	473	463	338	438	394	-849	170	503

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets</b>	22038	56044	53940	51787	49103	47604	47017	75611	70256	64742
<b>Cash &amp; Equivalents</b>	173	128	211	168	128	126	222	551	488	1690
<b>Accounts Receivable</b>	713	1768	1782	1862	1821	1789	1882	2245	2094	
<b>Inventories</b>	33	107	125	167	132	144	134	128	120	
<b>Goodwill &amp; Int. Ass.</b>	12140	32214	30597	28411	27295	26225	23978	43248	38810	21534
<b>Total Liabilities</b>	12391	35217	34651	34596	34080	33544	33618	52120	50428	51272
<b>Accounts Payable</b>	300	1400	1207	1111	1226	968	1179	1555	1933	
<b>Long-Term Debt</b>	7328	21836	20605	20966	20503	20225	19688	37726	36061	34694
<b>Shareholder's Equity</b>	9641	20827	19289	17191	15023	14060	13399	23491	19828	13470
<b>D/E Ratio</b>	0.76	1.05	1.07	1.22	1.36	1.44	1.47	1.61	1.82	2.58

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Return on Assets</b>	4.3%	1.5%	1.4%	-0.5%	1.5%	1.8%	1.3%	2.3%	-2.4%	-7.8%
<b>Return on Equity</b>	9.9%	3.8%	3.9%	-1.3%	4.8%	6.0%	4.6%	7.5%	-8.0%	-31.6%
<b>ROIC</b>	5.5%	1.9%	1.9%	-0.6%	2.1%	2.5%	1.9%	2.9%	-3.0%	-10.1%
<b>Shares Out.</b>	305	619	626	584	569	544	547	1,069	1,067	1,078
<b>Revenue/Share</b>	23.37	28.74	29.53	30.11	31.65	32.25	32.31	28.08	21.99	20.91
<b>FCF/Share</b>	3.92	3.35	5.06	4.18	3.76	4.11	3.01	1.23	3.62	2.85

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