Deutsche Telekom AG (DTEGY)

Updated February 20th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$18	**5 Year CAGR Estimate:**	7.0%	**Market Cap:**	$85.3 B
Fair Value Price:	$18	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	3/27/2020[1]
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.0%	**Dividend Payment Date:**	4/7/2020
Dividend Yield:	3.7%	**5 Year Price Target**	$22	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

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 about 184 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$85 billion.

The $26 billion merger between Sprint and T-Mobile has passed most hurdles but it has to pass a few more to be completed, such as the approval of Softbank of Japan, Sprint's controlling shareholder. 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 mid-February, Deutsche Telekom reported (2/19/20) financial results for the fourth quarter of fiscal 2019. In the year, net revenue grew 6.4% and adjusted net income grew 8.9% to a record of €4.9 billion. The U.S. segment maintained its strong momentum, with 5.0% net revenue growth thanks to the increase in the number of customers from 79.6 million to 86.0 million. It was the sixth consecutive year with more than 5 million customers added. Management expects 3% growth in EBITDA and 14% growth in free cash flows this year thanks to growth in all the operating segments. Despite the positive outlook, management will cut the annual dividend from €0.70 to €0.60 this 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.91	$0.92	$0.66	$0.63	$0.79	$0.77	$0.61	$0.89	$1.13	$1.14	***$1.20***	***$1.46***
DPS	$1.03	$0.99	$0.88	$0.93	$0.68	$0.56	$0.63	$0.65	$0.77	$0.78	***$0.66***	***$0.69***
Shares[2]	4,321	4,321	4,321	4,452	4,476	4,587	4,677	4,762	4,761	4,743	***4,730***	***4,700***

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 has grown its earnings-per-share by 5.9% 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 the record results in 2019, 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.

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[1] Estimated date.

[2] 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.4	14.9	17.2	20.4	20.3	23.1	27.7	20.2	14.6	14.7	***15.0***	***15.0***
Avg. Yld.	7.9%	7.2%	7.7%	7.2%	4.2%	3.2%	3.7%	3.6%	4.7%	4.6%	***3.7%***	***3.2%***

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 14, with an average value of 18.7. 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 now trading exactly at its fair earnings multiple. As a result, we do not expect valuation to have a meaningful effect on the total return of the stock over the next five years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

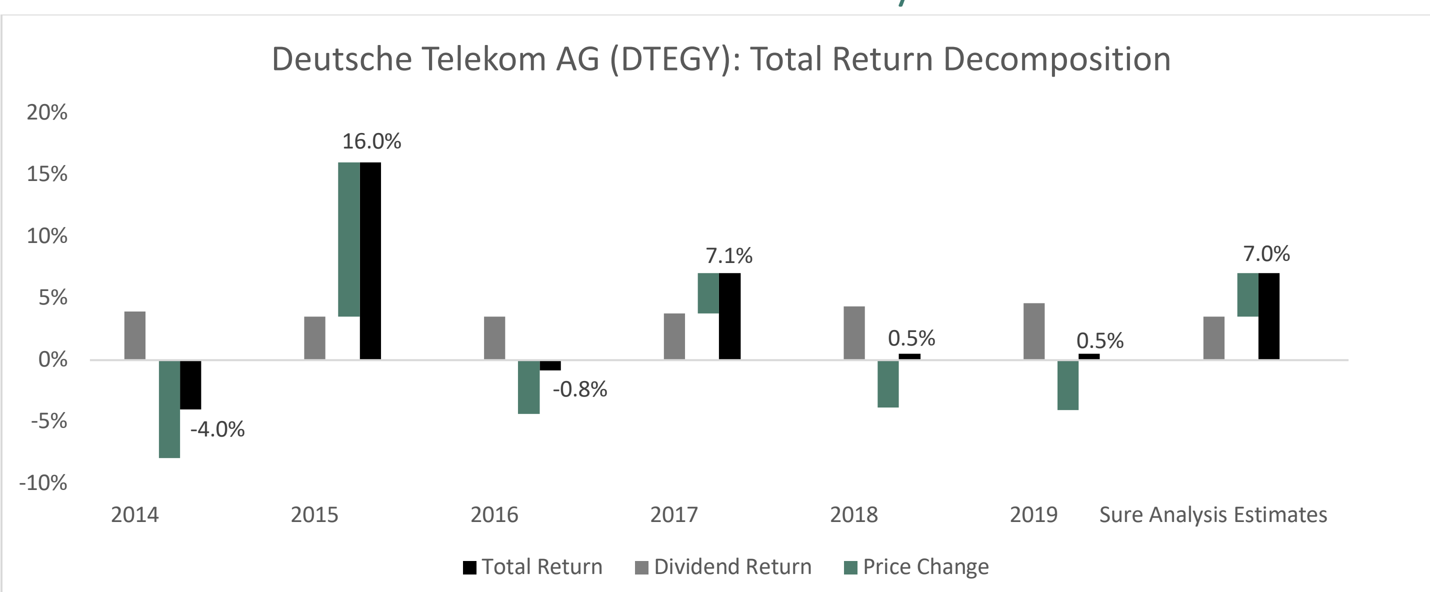
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	113%	108%	133%	148%	86.1%	72.7%	103%	73.0%	68.1%	68.2%	***55.0%***	***47.5%***

Deutsche Telekom has undisputed leadership within the European telecommunications market and is investing aggressively to maintain this position. Last year, the company invested €14.4 billion (US$15.8 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 six 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. As Deutsche Telekom is now near the top of its range, it may offer just a 7.0% average annual return over the next five years. We thus rate it as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	82739	81781	74784	79861	83325	76822	80899	84878	88975	89,767
Gross Profit	35386	34447	30743	31711	43290	39452	42180	44280	46772	51,133
Gross Margin	42.8%	42.1%	41.1%	39.7%	52.0%	51.4%	52.1%	52.2%	52.6%	57.0%
SG&A Exp.	26340	26883	24337	24324	314	353	336	399	509	477
D&A Exp.	15652	20128	28229	14481	14062	12606	14809	16519	16338	19,774
Operating Profit	8658	12493	7129	7538	6045	6591	7225	8204	9059	10,925
Op. Margin	10.5%	15.3%	9.5%	9.4%	7.3%	8.6%	8.9%	9.7%	10.2%	12.2%
Net Profit	2247	750	-6882	1235	3888	3611	2961	3920	2558	4,329
Net Margin	2.7%	0.9%	-9.2%	1.5%	4.7%	4.7%	3.7%	4.6%	2.9%	4.8%
Free Cash Flow	6468	10887	6615	2588	2060	426	2095	-2603	6443	

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	170	159	143	163	157	157	157	170	166	191
Cash & Equivalents	3735	4856	5324	11006	9148	7540	8190	3973	4208	6,041
Acc. Receivable	9162	8493	8353	10467	12479	9573	9704	11461	11425	12,149
Inventories	1742	1404	1463	1466	1828	2019	1722	2381	2048	1,756
Goodwill & Int.	71561	65059	55343	63474	62704	62345	64063	75419	74296	76,400
Total Liab. ($B)	113	107	102	119	116	116	116	119	117	139
Accounts Payable	8977	8337	8484	9985	11711	12067	10982	13118	12239	10541
Long-Term Debt	67224	62586	55433	67069	64049	63080	61847	64721	67178	
Total Equity	50560	45856	34290	32974	30932	32143	30980	36872	35355	35517
D/E Ratio	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	1.3%	0.5%	-4.6%	0.8%	2.4%	2.3%	1.9%	2.4%	1.5%	
Return on Equity	4.4%	1.6%	-17.2%	3.7%	12.2%	11.4%	9.4%	11.6%	7.1%	
ROIC	2.4%	0.6%	-6.5%	1.2%	3.6%	3.4%	2.9%	3.6%	2.2%	
Shares Out.	4,321	4,321	4,321	4,452	4,476	4,587	4,677	4,762	4,761	4,743
Revenue/Share	19.09	19.02	17.39	18.27	18.62	16.87	17.49	18.05	18.76	
FCF/Share	1.49	2.53	1.54	0.59	0.46	0.09	0.45	-0.55	1.36	

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