



Telephone & Data Systems (TDS)

Updated March 6th, 2019 by Quinn Mohammed

Key Metrics

Current Price:	\$21	5 Year CAGR Estimate:	12.8%	Market Cap:	\$2.5B
Fair Value Price:	\$29	5 Year Growth Estimate:	1.5%	Ex-Dividend Date:	03/16/2020
% Fair Value:	73%	5 Year Valuation Multiple Estimate:	8.5%	Payment Date:	03/31/2020
Dividend Yield:	3.3%	5 Year Price Target	\$31	Years of Dividend Growth:	45
Dividend Risk Score:	B	Retirement Suitability Score:	A	Last Dividend Increase:	3%

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 February 20th, TDS reported financial results for the fourth quarter and full year of 2019. For the fourth quarter, the company grew its total operating revenue by 0.3% year-over-year to \$1.34 billion. This growth is comprised of 1.2% growth at TDS Telecom and basically flat growth of 0.1% in U.S. Cellular. Diluted earnings per share fell by 28% year-over-year to \$0.10 a share. For the full year, operating revenue of \$5.18 billion increased 1.3% year-over-year. Diluted earnings per share fell 12% to \$1.03 for the full year. The company has 166 million shares outstanding, whereas last year there were a total 114 million shares outstanding, for a 2% increase.

The board of directors announced a 3% dividend increase for the first quarter of 2020, to \$0.17 per common share.

In 2020, U.S. Cellular will deploy 5G commercially in two markets and continue its VoLTE deployment.

Management provided outlook for the full year of 2020, and expect \$3 billion to \$3.1 billion for U.S. Cellular, practically flat compared to 2019 actual results. Estimates for TDS Telecom range from \$950 million to \$1 billion, a 5% increase from 2019 actual results of \$930 million. Total estimated revenue for 2020 is now \$4.03 billion, a large decline (-22%) from actual revenue of \$5.18 billion in 2019. Capex is estimated to be roughly \$1.23 billion for the full year 2020.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.31	\$1.83	\$0.75	\$1.29	-\$1.26	\$1.98	\$0.39	\$1.37	\$1.17	\$1.03	\$1.20	\$1.30
BPS¹	\$33.75	\$33.60	\$37.16	\$37.85	\$36.39	\$37.86	\$37.67	\$38.45	\$40.00	\$40.46	\$41.07	\$44.24
DPS	\$0.44	\$0.48	\$0.48	\$0.52	\$0.52	\$0.56	\$0.60	\$0.60	\$0.64	\$0.66	\$0.68	\$0.79
Shares²	113	118	108	109	108	109	110	112.0	115	116	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 2.6% compounded per year on average. On the other hand, thanks to the momentum of U.S. Cellular, we expect TDS to earn about \$1.20 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 \$44.24 by 2025 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2024
Avg. P/B	0.99	0.87	0.64	0.67	0.70	0.74	0.73	0.75	0.73	0.73	0.46	0.70
Avg. Yld.	1.4%	1.6%	2.1%	2.0%	2.1%	2.1%	2.1%	2.2%	2.2%	2.3%	3.6%	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 0.46, which is lower than its 10-year average of 0.74. If the stock reverts to its average valuation level over the next five years, it will enjoy an 8.6% annualized gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2024
Payout	31%	23%	65%	40%	---	28%	151%	45%	55%	64%	57%	61%

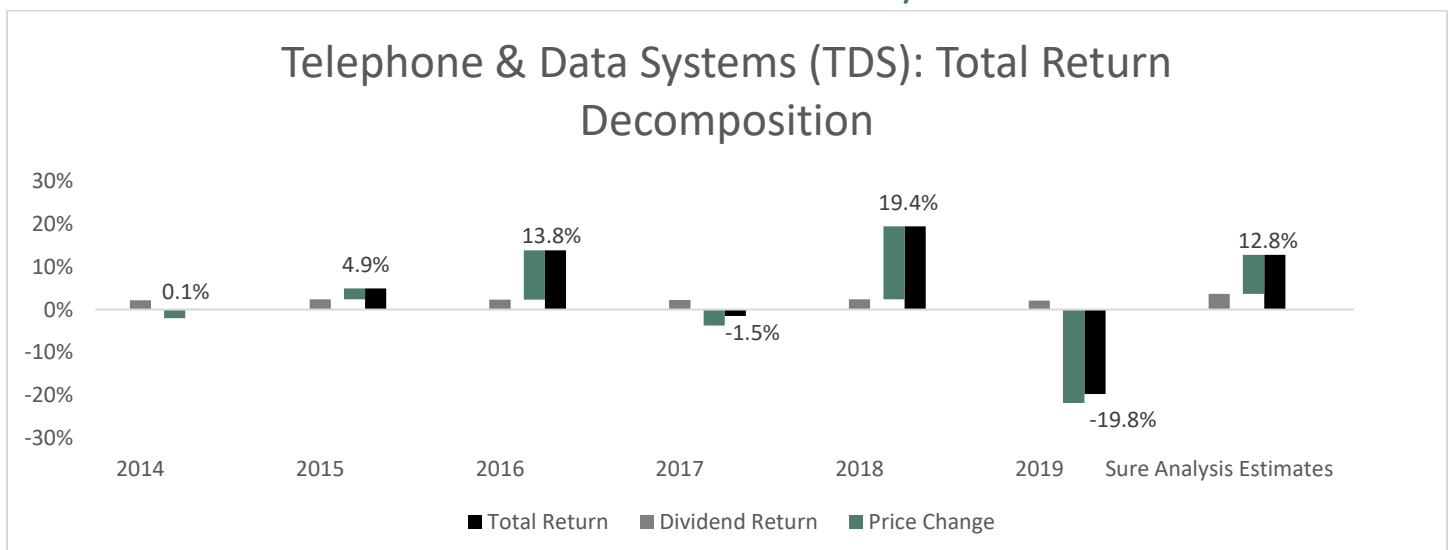
TDS has raised its dividend for 45 consecutive years. It has grown its dividend by 4% per year on average over the past 5 years. Today, its 3.3% dividend yield is more than 100 basis points above the yield of the S&P. Moreover, the company has exhibited serious volatility in its results. This is a negative 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 expects lower revenue than last year, which negatively affects the share price. We forecast the stock will offer a 12.8% average annual return over the next five years. We have been somewhat conservative in our growth 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. We rate TDS a hold and think there are better opportunities in the telecom space, namely AT&T.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	4987	5180	5345	4901	5009	5210	5155	5044	5109	5176
Gross Profit	3062	3130	3073	2676	2498	2795	2726	2685	2773	2839
Gross Margin	61.4%	60.4%	57.5%	54.6%	49.9%	53.6%	52.9%	53.2%	54.3%	54.8%
SG&A Exp.	1998	2002	2034	1948	1865	1781	1762	1689	1694	1717
D&A Exp.	756	766	814	1018	837	844	850	844	883	932
Operating Profit	308	362	225	-290	-204	170	114	152	196	190
Operating Margin	6.2%	7.0%	4.2%	-5.9%	-4.1%	3.3%	2.2%	3.0%	3.8%	3.7%
Net Profit	145	201	82	142	-136	219	43	153	135	121
Net Margin	2.9%	3.9%	1.5%	2.9%	-2.7%	4.2%	0.8%	3.0%	2.6%	2.3%
Free Cash Flow	337	284	110	-389	-404	-11	146	91	241	59
Income Tax	95	114	74	126	-5	172	40	-279	46	64

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	7763	8201	8624	8904	8854	9422	9446	9295	9783	10781
Cash & Equivalents	368	563	740	830	472	985	900	619	921	465
Accounts Receivable	513	394	410	552	549	705	753	861	992	1005
Inventories	116	130	161	245	274	158	151	145	150	169
Goodwill & Int. Ass.	2219	2342	2336	2456	2534	2901	2938	3020	2957	3266
Total Liabilities	3301	3598	3968	4234	4399	4718	4696	4403	4490	5377
Accounts Payable	344	365	377	496	387	349	365	368	365	374
Long-Term Debt	1502	1531	1723	1722	1942	2454	2445	2457	2439	2326
Shareholder's Equity	3814	3962	4012	4118	3926	4126	4144	4269	4560	4653
D/E Ratio	0.39	0.39	0.43	0.42	0.49	0.59	0.59	0.58	0.53	0.50

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.9%	2.5%	1.0%	1.6%	-1.5%	2.4%	0.5%	1.6%	1.4%	1.2%
Return on Equity	3.8%	5.2%	2.1%	3.5%	-3.4%	5.4%	1.0%	3.6%	3.1%	2.6%
ROIC	2.4%	3.3%	1.3%	2.2%	-2.1%	3.2%	0.6%	2.1%	1.8%	1.6%
Shares Out.	113.0	117.9	107.9	108.8	107.9	109.0	110.0	112.0	115.0	116.0
Revenue/Share	45.13	47.48	49.07	44.91	46.38	47.36	46.44	45.04	44.82	44.62
FCF/Share	3.05	2.60	1.01	-3.57	-3.74	-0.10	1.32	0.81	2.11	0.51

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

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