

CenturyLink (CTL)

Updated August 10th, 2020 by Quinn Mohammed

Key Metrics

Current Price:	\$10.9	5 Year CAGR Estimate:	10.7%	Market Cap:	\$11.9B
Fair Value Price:	\$12.2	5 Year Growth Estimate:	1.3%	Ex-Dividend Date:	09/02/2020
% Fair Value:	89%	5 Year Valuation Multiple Estimate:	2.4%	Payment Date:	09/13/2020
Dividend Yield:	9.2%	5 Year Price Target	\$13	Last Dividend Increase:	0
Dividend Risk Score:	D	Retirement Suitability Score:	B	Years of Dividend Growth:	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 \$11.9 billion market capitalization and produced \$22 billion in revenue in 2019.

CenturyLink reported second quarter results on August 5th. Total revenues for the quarter was \$5.2 billion, down from \$5.4 billion from the prior year period. Adjusted earnings per share for the second quarter was \$0.42, up 24% year-over-year from \$0.34. The company's long-term debt has been reduced by \$980 million since the end of 2019 and has total long-term debt of \$31.4 billion remaining.

Total broadband subscribers fell from 4,750 one year ago to 4,638 today, for a decrease of 3.5%. Despite this, and for many quarters in a row, broadband revenue was actually the only consumer metric which did not decrease YoY, with revenue increasing 1.1%. This is due to the loss of subscribers in broadband being at the lower tier of offerings, while the higher tiers are increasing. Total revenue, on the other hand, dropped 3.4% YoY, but only 0.7% quarter-over-quarter to \$5.2 billion.

The company failed to continue the expansion of their adjusted EBITDA margin, as it shrunk from 42.2% last year to 41.9% this year, given the ongoing COVID-19 pandemic, we do not fault them. They also achieved \$620 million of annualized run-rate adjusted EBITDA cost transformation savings against the three-year goal of \$800 million to \$1 billion. Due to further progress on deleveraging initiatives and improved maturity profiles, the company is lowering interest expense outlook for the year by \$100 million. Forecasted GAAP Interest expense still comes in at a whopping \$1.7 billion for 2020. Other metrics such as dividends, cash interest, depreciation, and income taxes unchanged.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$3.41	\$1.07	\$1.25	\$1.64	\$2.61	\$2.72	\$2.45	\$1.58	\$1.19	\$1.32	\$1.36	\$1.45
DPS	\$2.90	\$2.90	\$2.90	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$1.00	\$1.00	\$1.00
Shares¹	305	619	626	584	569	544	547	1,069	1,067	1,078	1,080	1,100

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 1.3% 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.

¹ 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	10.8	8.0	9
Avg. Yld.	7.8%	7.5%	7.4%	6.2%	5.9%	6.9%	7.7%	9.8%	11.4%	13.0%	9.2%	7.7%

CenturyLink's volatile price-to-earnings ratio stands at 8.0 now as earnings remain below record levels. We have lowered our fair value estimate to 9 times earnings given the marked weakness in the company's recent results, representing a 2.4% 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 strong, at 7.7%.

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%	74%	69%

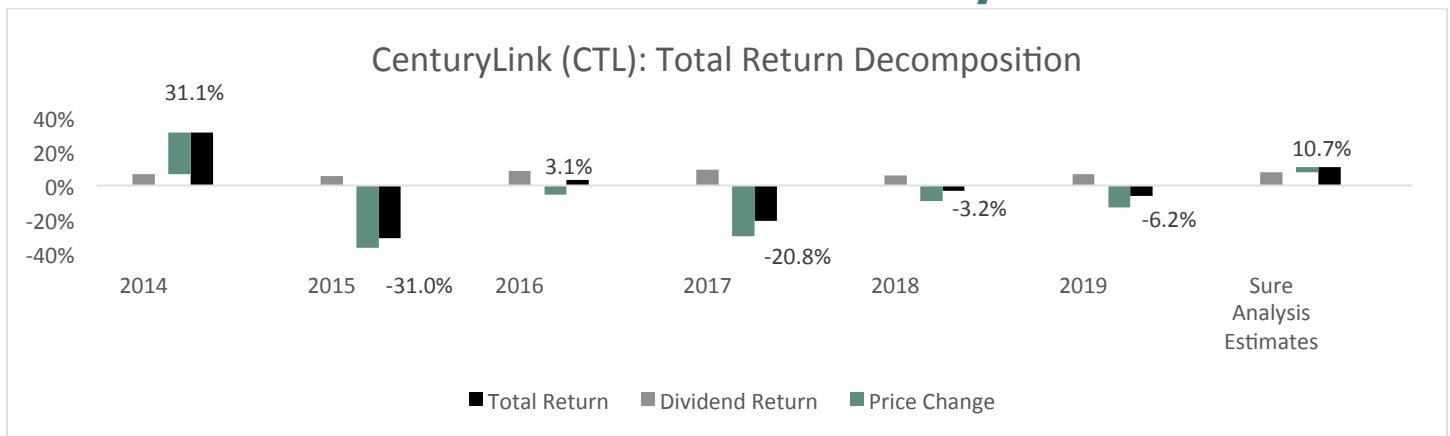
CenturyLink's payout ratio is now back under 100% after the dividend cut, and we expect the dividend will remain at \$1 per share for the foreseeable future. Management has made it clear the priority is reducing leverage, so we see the payout ratio drifting lower over time as earnings grow but the dividend 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. While the COVID-19 pandemic overhangs the economy, CTL has a large and diversified customer base, with only 5%, or \$1B, of total revenue coming from highly impacted customers (retail, restaurants, hotels, etc.).

Final Thoughts & Recommendation

CenturyLink is a stock that offers positive growth potential and a large yield. We see total returns of 10.7% going forward, half of which comes from the dividend. 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
Revenue	7042	15351	18376	18095	18031	17900	17470	17656	23443	22401
Gross Profit	4498	9026	10737	10588	10185	10122	9696	9453	12581	12324
Gross Margin	63.9%	58.8%	58.4%	58.5%	56.5%	56.5%	55.5%	53.5%	53.7%	55.0%
SG&A Exp.	1004	2975	3244	3502	3347	3354	3447	3508	4165	3715
D&A Exp.	1434	4026	4780	4541	4428	4189	3916	3936	5120	4829
Operating Profit	2060	2025	2713	2545	2410	2579	2333	2009	3296	3780
Operating Margin	29.3%	13.2%	14.8%	14.1%	13.4%	14.4%	13.4%	11.4%	14.1%	16.9%
Net Profit	948	573	777	-239	772	878	626	1389	-1733	-5269
Net Margin	13.5%	3.7%	4.2%	-1.3%	4.3%	4.9%	3.6%	7.9%	-7.4%	-23.5%
Free Cash Flow	1181	1790	3146	2511	2141	2281	1627	772	3857	3052
Income Tax	583	375	473	463	338	438	394	-849	170	503

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	22038	56044	53940	51787	49103	47604	47017	75611	70256	64742
Cash & Equivalents	173	128	211	168	128	126	222	551	488	1690
Accounts Receivable	713	1768	1782	1862	1821	1789	1882	2245	2094	
Inventories	33	107	125	167	132	144	134	128	120	
Goodwill & Int. Ass.	12140	32214	30597	28411	27295	26225	23978	43248	38810	21534
Total Liabilities	12391	35217	34651	34596	34080	33544	33618	52120	50428	51272
Accounts Payable	300	1400	1207	1111	1226	968	1179	1555	1933	
Long-Term Debt	7328	21836	20605	20966	20503	20225	19688	37726	36061	34694
Shareholder's Equity	9641	20827	19289	17191	15023	14060	13399	23491	19828	13470
D/E Ratio	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
Return on Assets	4.3%	1.5%	1.4%	-0.5%	1.5%	1.8%	1.3%	2.3%	-2.4%	-7.8%
Return on Equity	9.9%	3.8%	3.9%	-1.3%	4.8%	6.0%	4.6%	7.5%	-8.0%	-31.6%
ROIC	5.5%	1.9%	1.9%	-0.6%	2.1%	2.5%	1.9%	2.9%	-3.0%	-10.1%
Shares Out.	305	619	626	584	569	544	547	1,069	1,067	1,078
Revenue/Share	23.37	28.74	29.53	30.11	31.65	32.25	32.31	28.08	21.99	20.91
FCF/Share	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.